TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 947

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, PETITIONER

vs.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

PETITION FOR CERTIORARI FILED FEBRUARY 12, 1942

CERTIORARI GRANTED MARCH 16, 1942

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A In the District Court of the United States for the District of Maryland

Civil No. 512

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, PLAINTIFFS

vs.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, DEFENDANT

Stipulation of facts

Filed Dec. 17, 1940

It is hereby agreed and stipulated by and between the parties hereto, by their respective counsel, that the above-entitled cause shall be submitted to the Court for its decision on the following facts:

In November 1938, the Commissioner of Internal Revenue assessed the Plaintiffs the following deficiency income taxes for the calendar years 1936 and 1937:

1936		1937	
Tax	$3,399.71	Tax	$646.24
Interest	327.44	Interest	23.46
Total	3,727.15	Total	669.70

These amounts were paid by the Plaintiffs, on November 21, 1938, under protest. Later and prior to the filing of the amended complaint, appropriate claims for refund of the parts thereof hereinafter mentioned were filed with and denied by the Commissioner.

Included in the 1936 deficiency assessment is $200.68, and interest $19.33, which represents the amount the Plaintiffs were compelled to pay by reason of the disallowance of deduc-

B tions for the taxpayers' proportionate share of the 1936 City and State taxes paid by the Plaintiffs on certain real estate acquired by them during that year, and which amount they had deducted from their 1936 income tax return.

Similarly, included in the 1937 deficiency assessment is $640.26, and interest $23.24, which represents the amount the Plaintiffs were compelled to pay by reason of the disallowance of deduction for the taxpayers' proportionate share of 1937 City and State taxes paid by the Plaintiffs on certain real estate acquired by them during that year, and which amount they had deducted from their 1937 income tax return.

It is further agreed and stipulated that the seller of the properties involved herein only claimed deductions in its income tax return for State and City taxes proportionate to the date of sale.

It is further agreed and stipulated that all errors in pleading are waived and that the Court, in the event it shall hold that all the said deductions were properly allowable to the Plaintiffs by the Commissioner, shall enter judgment for the Plaintiffs against the Defendant for the sum of $883.51, with interest thereon from November 22, 1938, as provided by law.

It is further stipulated by counsel on both sides that they each reserve the right to produce additional testimony, should they deem the same advisable, at the hearing of this cause, not inconsistent herewith.

NATHAN J. FELSENBERG,
Attorney for Plaintiffs,
BERNARD J. FLYNN,
United States Attorney,
Attorney for Defendant.

1 *Appendix to appellant's brief*

In the District Court of the United States for the District of Maryland

Civil No. 512

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, PLAINTIFFS

v.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, DEFENDANT

Judgment

1 Filed Feb. 3, 1941

This cause having duly come on for hearing before the Court, without a jury, and having been submitted for decision and judgment on the pleadings and the evidence, and the Court having heard arguments of attorneys for the respective parties, and having duly considered the briefs filed by them, and having duly considered the pleadings and evidence, and having filed herein its combined written opinion, findings of fact, and conclusions of law,

It is now ordered, adjudged, and decreed that the plaintiffs, Frederick M. Supplee and Elizabeth G. Supplee, do hereby re-

cover from the defendant the sum of $793.45, together with interest thereon from November 22, 1938, as provided by Section 177 of the Judicial Code as amended, as amended by Section 615 (b) of the Revenue Act of 1928 (45 Stat. 877; U. S. C., Title 28, Section 284).

And further, the Court certifies that the defendant acted in his official capacity in collecting the money herein recovered, and there was probable cause for his action.

2 And further, that in accordance with the provisions of Section 989 of the United States Revised Statutes (U. S. C., Title 28, Section 842), the amount so recovered, shall upon final judgment be provided for and paid out of the proper appropriation from the Treasury.

(s) W. CALVIN CHESNUT,
United States District Judge.

FEBRUARY 3, 1941.

In the District Court of the United States for the District of Maryland

Civil No. 512

FREDERICK M. SUPPLEE, AND ELIZABETH G. SUPPLEE, PLAINTIFFS

v.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE OF THE STATE OF MARYLAND, DEFENDANT

Opinion

CHESNUT, D. J.:

This personal federal income tax case involves a comparatively small sum of money, but is of particular practical interest to dealers in real estate. The question involved is whether a purchaser of real estate, who has adjusted the taxes on the property pursuant to the contract of sale, and afterwards pays the whole year's taxes, can properly deduct in his federal income tax return for the year the proportion of the taxes for that year which

3 was allocated to him in the adjustment. It probably will be a surprise to many dealers in real estate to learn that it is the Government's contention that the purchaser may not so deduct his proportion of the taxes, but must capitalize the amount assumed and paid by him as a part of the cost of the purchase. In this case the Commissioner of Internal Revenue disallowed the deductions, the taxpayers paid the deficiency taxes, and after denial of petition for refund, have sued to recover the alleged overpayments. The taxpayers kept their accounts on a cash, and not an accrual basis.

The plaintiff taxpayers in this case, Frederick M. Supplee and his wife, in 1936, and again in 1937, purchased several small apartment houses, in pursuance of what appears to have been a substantial business by them in real estate in Baltimore City, as they own numerous properties of this general class which they hold, operate, and manage for a profit. In the case of the several properties which they bought in 1936 and 1937, the taxes and other expenses on the property were adjusted between the seller and the purchasers in accordance with the contract of sale; and thereafter Mr. Supplee paid to the City Collector of Baltimore the full amount of the tax bills on the properties in and for the respective years in which they were purchased. In their income tax returns for these years they deducted from gross income the proportion of taxes allocated to them in the adjustments made at the time of the transfers, but did not include in the amount of the deductions the portion of the tax bill which in the adjustments was allocated to the vendors. It further appears that the latter in their income-tax returns deducted only the proportion of the taxes for the year which had been allocated to them in the adjustments.

It will be sufficient to give the details of one transaction which is typical of all. Sometime prior to May 10, 1936, the taxpayers entered into an agreement, in customary form in Baltimore City, to buy the apartment property known as 2325-2333 Reisterstown Road for $25,000. The contract provided for the adjustment of taxes and other expenses on the property. On May 10, 1936, the transaction was settled and on the settlement sheet the pur-
4 chasers were credited with the proportion of the taxes, both City and State, for the whole year of 1936 on the property which had accrued up to May 10th; and thereafter in due course Mr. Supplee paid the tax bills of the property for the whole year. In the settlement, other expenses on the property, including ground rent and water rent, were also adjusted by the seller and buyer. In preparing Mr. Supplee's income tax returns his bookkeeper inadvertently and erroneously failed to make proper distinction between adjustment of taxes and other items, and in one case seems to have inadvertently included among taxes deducted a portion or all of the amount allocated to the seller; but these mistakes have now been corrected, and to simplify the accounting problem it will be sufficient to state that it is the uncontradicted testimony in the case that, (1) apart from the question as to the deduction of proportioned taxes, the taxpayers have overpaid their taxes for 1936 and 1937 in the aggregate amount of $145.02, by reason of the failure to include among proper deductions various items of ground rent, water rent, and other

adjustments which constituted properly deductible "expenses"; and (2) if the taxpayers are also entitled to deduct their allocated portion of the adjusted taxes for two years then they are entitled to recover as overpayment the total sum of $793.45 with interest from November 22, 1938. In this respect the testimony has corrected the somewhat higher figure included in a stipulation previously filed in the case.

The applicable statutory provision is Section 23 of the Revenue Act of 1936 (see U. S. C. A., Title 26, Internal Revenue Acts 1924 to date, page 827), which provides, as far as applicable, as follows:

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

"(c) Taxes Generally.—Taxes paid or accrued within the taxable year, except" (the exceptions are not relevant in this case).

Similarly worded provisions were contained in prior and subsequent Revenue Acts.

If the statute had not specifically provided for deductions of taxes paid, it would seem reasonably clear that the taxpayers in this case would have been entitled to deduct the taxes allocated to and paid by them as an ordinary and necessary expense in carrying on their real estate business, just as they were clearly entitled to deduct the payment of ground rents, water rents and other necessary expenses on the properties, the income from which they of course had to include in their gross income. It is the uncontradicted testimony in this case that by reason of failure to properly itemize certain deductions of ground rent and water rent and possibly other items of expenses, the taxpayers have overpaid their taxes in the amount of $145.02 plus interest. I do not understand that any technical objection with respect to the procedure for refund was made by the defendant in this case to the recovery of at least that much by the taxpayers. However, it is argued for the defendant Collector that, as taxes have been specifically provided for in the statute, the question of their deductibility under the facts of this case must be justified if at all by the particular phraseology of the statute with respect to tax deductions. The language of this is exceedingly clear and simple. It permits the taxpayer to deduct "taxes paid or accrued within the taxable year." It is said for the defendant that the alternative of "paid or accrued" has reference to the alternative conditions, whether the taxpayer's return is on a cash or accrual basis; if on the cash basis then taxes paid are deductible; and if on accrual basis then taxes accrued are deductible. (See

U. S. v. Anderson, 269 U. S. 422; Comr. v. Coward, 3 Cir., 110 F. (2d) 725, 727.) It is also perfectly clear that the taxpayers in this case bring themselves precisely within the literal language of the statute in that they did pay the taxes within the taxable year. It is, however, the contention of the defendant Collector that the phrase "taxes paid" must be construed as if it read "taxes paid if assessed on the tax rolls to the taxpayer"; and that as so construed the taxpayers in this case are not entitled to the deduction, even though they ask only for the deduction of that portion of the taxes for the whole year which
6 accrued during their ownership of the property, and which of course they had to pay to continue in enjoyment of the property. As I understand it, the position of the defendant is that the taxpayer is not entitled to deduct taxes paid by him by reason of his ownership of the property unless he is personally liable to the taxing authority for the tax bill, irrespective of the lien of the taxes on his property. It is the defendant's further position that instead of the owner's deducing the amount of the taxes from his income he must capitalize the taxes so paid as a part of the cost price of the property.

Before beginning the discussion of the point of law thus raised, it is desirable to first refer to the legal incidents of the Maryland taxing system and the customary handling of real estate transactions in Baltimore City. I am referring to these not as necessarily controlling the determination of the particular question, but as a factor to be considered in connection with the defendant's construction of the federal statute. In Maryland taxes on real estate (but not on personal property) become a lien upon the property when due and so continue until paid; (Flack's 1939 Md. Code, Art. 81, S. 72); and are also apparently a personal liability of the owner in whose name the property is assessed on the tax rolls on the date of "finality." Md. Code Art. 81, S. S. 2 (20) and 154; Bassett v. Ocean City, 118 Md. 114, 119; Free v. Greene, 175 Md. 36, 41; Mayor and City Council of Baltimore v. Perrin, Md. Ct. of Appeals, April 4, 1940, Baltimore Daily Record, April 13, 1940. The taxes with which we are here dealing are those imposed on real estate by the State of Maryland, and also those separately imposed under the statutes by Baltimore City. Both classes of taxes become due and payable on January 1st of each year for that current year, although the City taxes are not in default for nonpayment until July 1st (after which time if not paid interest and penalties at a prescribed rate accrue thereon), and the State taxes become in default if not paid by January 1st of the succeeding year. (Md. Code Art. 81, S. 74.) It is also to be noted that in Baltimore City the "date of finality" with respect to City taxes is October 1st in

the year prior to the taxable year. The person who owns the property on October 1st and is assessed for it on the
7 assessment rolls thereby becomes liable for the taxes for the succeeding calendar year, even though he may sell and dispose of the property between October 1st and January 1st, when the taxes first become actually payable. In re Wells, 4 F. S. 329 (D. C. Md.). It is also to be noted, as appears from the uncontradicted testimony in this case, that it is the almost universal custom in Baltimore City, and has been for many years, that as between seller and buyer of real estate, taxes are adjusted to the date of settlement and transfer of the property. That is to say, if the settlement date is July 1st the seller is charged with one-half of the tax bill for the whole calendar year and the buyer with the other half, and so proportionately with respect to settlement at any other date during the calendar year. If the taxes have not been paid by the seller prior to the settlement date the purchaser assumes the whole tax bill and is credited with that proportion of the year's taxes which has accrued up to the date of settlement. If the seller has already paid the taxes for the year he is credited with that proportion of the taxes allocated to the purchaser. It also appears from the testimony in this case of two experienced certified public accountants that for many years past, in preparing income tax returns for their clients, they have habitually deducted taxes as adjusted between seller and buyer as was done in this particular case by the taxpayers.

Counsel for the defendant Collector contends in this case that the taxes as adjusted and paid by the taxpayers were not deductible because (1) the taxes became a lien on the property in the hands of the former owner, and (2) there was no personal liability on the taxpayers for any part of the taxes for the year directly to the local taxing governments. In support of this position reference is made to Treasury regulation 94, promulgated under the Revenue Act of 1936, Article 34 (C)-1 which provides that in general taxes are deductible only by the person upon whom they are imposed; and to certain decisions by the Board of Tax Appeals and in the 6th and 8th Circuits which, in general terms, state that taxes assessed and constituting a lien on real estate before a sale may not be deducted
8 when paid thereafter by a purchaser, but must be treated as a part of the cost of the property. Illustrative cases are California San. Co. v. Comr., 32 B. T. A. 122; Merchants Bank Bldg. Co. v. Helvering, 8 Cir., 84 F. (2d) 478; Lifson v. Comr., 8 Cir., 98 F. (2d) 508; Walsh-McGuire Co. v. Comr., 6 Cir., 97 F. (2d) 983. Thus it is succinctly stated in the Lifson case, page 510, as follows:

When one purchases land which is subject to a lien for taxes, the subsequent payment of those taxes by the purchaser does not constitute an allowable deduction from gross income, for the reason that the taxes accrued while the land was in other ownership and the payment of them is merely a payment of a part of the cost of acquiring the property."

But it will be found on examination that these cases (with one exception noted) have not dealt with the deduction of taxes adjusted for a current tax year, which is the problem here presented. It is clear enough that unpaid taxes for a prior year, which are properly a charge against income for that year, wholly preceding the new ownership, must be treated as a part of the cost, and (as is almost universally the case in Baltimore City) are credited to the purchaser on the settlement sheet at the time of the transfer of the property. We are dealing here only with taxes for a current year as allocated to the seller in proportion to the period of the year for which he has the ownership. In a similar case the adjusted taxes were allowed to the purchaser as a deduction for the current year in John Hancock Mutual Life Ins. Co. v. Comr., 10 B. T. A. 736; and see Helvering v. Missouri State Life Ins. Co., 8 Cir., 78 F. (2d) 778, 781; and Comr. v. Coward, 3 Cir., 110 F. (2d) 725. But more importantly for the instant case, the Circuit Court of Appeals for this fourth circuit has very recently decided a case, which on the facts is quite similar to the present case, and the reasoning of which I think supports the view that the taxpayers in this case were entitled to the deductions for taxes paid. Comr. v. Rust, 4 Cir., Dec. 18, 1940. The case is of course imperative authority here to the extent that it is applicable.

In the Rust case the taxpayer bought real estate in Washington, D. C., on September 17, 1935, the fiscal tax year being July 1st to June 30th, with tax payments due semiannually in September and March. The taxes for the fiscal year were adjusted to the date of transfer of the property between the vendor and the taxpayer purchaser in accordance with the contract of sale. The taxpayer deducted the proportion of the taxes paid by him in March 1936 in his federal income tax return for that year. This was disallowed by the Commissioner, but sustained by the Board of Tax Appeals, and affirmed on appeal to the fourth circuit, Judge Soper writing the opinion (Judge Parker dissenting). If the Rust case is distinguishable at all from the present case, the distinction lies only in the difference between the Maryland taxing system and that of the District of Columbia. The differences so far as applicable to this case are (1) although the taxes in Washington are assessed prior to the beginning of the fiscal year they

do not become a lien until they are in arrears and proceedings are taken to enforce payment; (2) the owner of real estate is apparently not personally liable for the taxes but only the property itself; and (3) the taxes are payable in semi-annual installments and only the second installment due in March 1936 was involved in the Rust case. The contention of the Commissioner there, as in this case, was that, as the taxes had been assessed to the prior owner of the property, the purchaser was not entitled to deduct his allocated proportion thereof for the current fiscal year but was obliged to capitalize the amount as a part of the cost price. This contention was definitely rejected by the court, Judge Soper saying with respect thereto in the opinion:

"But this theory is not in accord with the actualities of the ordinary case * * * Furthermore, the Commissioner's theory does violence to the purpose of the income tax statutes that items of income shall be accounted for in annual periods. Clearly this purpose will not be served if the constantly recurring burden of the tax is refused recognition as an item of current expense and is placed in the category of a capital expense to be reckoned with under the income tax statutes only in the event of sale at some future date."

Again it was said in the opinion:

"Taxes upon real estate, constitute an ever recurring burden; and when, as in this case, the property is held as an investment, they are perforce treated as a current expense to be offset against current income. The provision of the agreement of sale that the taxes should be adjusted to the date of sale was therefore natural and proper, since it allotted to each party a part of the burden proportionate to the period during which he possessed the property and enjoyed the income. Such an arrangement between buyer and seller is typical, and it would be in accord with the facts even if prior to the sale the tax has not only been assessed but has given rise to a lien. The apportionment of the tax was clearly correct in the transaction under discussion, since no part of the second installment of the tax could be fairly allotted to the seller and no part of it was collectible by the District during his period of ownership. The burden of paying this installment was an obligation which passed to the taxpayer with the ownership, in much the same fashion that the benefit of certain covenants is held to run with the land in the law of property; and the burden of the tax rested upon the taxpayer in a very real sense, for a delinquency would have been followed by a forced sale by the tax authorities."

The opinion in the Rust case also discusses and summarizes the prior cases above referred to, points out certain differences

between the case under consideration and the prior cases and concludes:

"Whether this attitude should not also be taken in the event of a sale after personal liability on the part of the seller or a statutory lien for the tax has arisen, we have no occasion to decide. The question here is whether, in the absence of personal liability and of a lien, the parties may agree to apportion a tax, not yet payable, to their respective periods of ownership. We think that they may; because such an agreement merely assigns to each party the obligation to bear his own burden of taxation."

11 It is therefore true that the Rust case is not an expressly controlling authority for the instant case, because the Maryland statutory scheme of taxation differs technically at least from that in the District of Columbia; but a careful reading of the opinion leads me to the conclusion that the reasoning and principle of decision should control this case in favor of the taxpayer.

As pointed out in the Rust case, taxes are an annually recurrent burden on real estate, whether a lien or not. In this respect they are not different from ground rents, water rents, and other fixed charges on property. To the extent that they are current they are properly chargeable to maintenance and not to capital by proper accounting practice. They are necessarily a charge against income and not an addition to capital. On the other hand, unpaid taxes for prior years are not properly chargeable to current income for a subsequent year, and, on a change of ownership of property, necessarily constitute a part of the cost of the property. The statutory provision for the deduction of taxes should be applied in the light of the subject matter. The federal income tax is a tax on net and not on gross income; and the accounting with the government is put on an annual basis. The general purpose of the income tax is to find and tax the true net income as defined in the statute. This is accomplished only when current taxes and similar items are deducted from the current income. When an income taxpayer purchases investment property he is chargeable only with the income subsequently accruing from the property, and current charges against it are properly deductible to ascertain the net income. If the current income is adjusted to the date of transfer, similarly the current charges against the income should be likewise adjusted.

The federal income-tax statute allows deduction for taxes paid or accrued during the taxable year. The wording is plain and simple and, in the context of the whole statute, seems to clearly mean that the current tax burden on property is to be deducted from current income from the property. In specifically men-

tioning taxes, in addition to current expenses, Congress probably had in mind the fact that expenses generally are deductible only with respect to a business, while taxes may also be deducted if paid on property owned for personal needs or pleasure,
12 as in the case of a dwelling. It is true, as provided in the applicable Treasury regulation (T. R. 94, Art. 34 (C)–1) that in general taxes are deductible only by the person upon whom they are imposed, and this is normally the case. Obviously a gratuitous payment of some other person's taxes would not be deductible by an income taxpayer. But if the relationship of the taxpayer to the property is such that he must, as a practical matter, pay the tax to continue in the enjoyment of the income or use of the property, the statute is gratified because the payment is a necessary charge against the income if any from the property.

The statute does not condition the deductibility of the taxes paid on the ownership of the property at the time of the assessment for local taxes, or on the particularities of the varying statutory schemes in the several states; and to cut down the taxpayer's right to the deduction by reason of the technical requirements of local taxation seems to contravene the plain words of the federal statute. It also introduces an unnecessary and undesirable lack of uniformity in the administration of the federal statute in the several states. Nor does it necessarily benefit the federal revenue, because, if the purchaser of property must capitalize the current taxes, his profit is less, or loss greater, when he resells, and his taxable income is thus diminished.

It is said for the defendant that in this case the taxpayers have paid the seller's taxes. But this is not so in reality. True the seller remained primarily liable to the local government, but, with respect to the property itself, the purchaser had the direct liability to pay the taxes to save it from tax sale; and legally the purchaser was directly liable to the seller to pay the taxes for the current year which he had assumed in the adjustment. We must bear in mind that we are applying the federal statute, and the accounting is between the taxpayers and the federal government with respect to what is the net income of the taxpayers. The details of the local tax statutes do not control the matter except insofar as they necessarily affect the determination of the net income. That the property was subject to a lien for taxes shows that the purchaser who had assumed the taxes was really the person obliged to pay them to avoid the loss of the
13 property, and in paying them he discharged his own obligation, rather than that of another. In accounting with the federal government, it is immaterial that, with respect to the local taxing authority, the seller was primarily liable, and the

purchaser liable over to the seller. The ultimate legal liability for the taxes was clearly on the purchasers in this case; and as they necessarily sustained the burden of the tax payments, there is no reason to deny them the deduction in their income-tax accounting with the federal government. It thus becomes clear that the mere fact that the seller was the owner of the property at the time the local tax assessment was made, and therefore the debtor to the local government, as the named owner on the tax rolls, is legally immaterial in the federal tax problem.

I conclude that the plaintiffs are entitled to recover for overpayment of taxes in 1936 and 1937 the sum of $793.45 with interest. Counsel may submit the appropriate order for judgment, with provision for interest in accordance with the specially applicable statute. I assume this opinion will be a sufficient finding of facts and conclusions of law, but if more is desired, they can be submitted for consideration.

(s) W. CALVIN CHESNUT,
United States District Judge.

JANUARY 22, 1941.

14 *Plaintiff's exhibit one*

(Settlement Sheet—12/17/40)

TITLE GUARANTEE AND TRUST COMPANY

MEMORANDUM OF SETTLEMENT

App. No. 76436.

Sale made by Royal Realty Corp to Frank H. Creese & Co.

Property 2325-2327 Reisterstown Rd.
Adjustment made to May 10th, 1936.

Credit to Seller:		
Amount of Purchase Price		$25,000.00
Total Credit to Seller		$25,000.00
Deduct:		
Cash paid on account	$200.00	
Rent allowances less stove adjustment	84.80	
1936 Taxes (Current Year) 4⅓ months	398.67	
Allowance	25.86	
Mortgages and interest thereon to Vendors	20,000.00	
Sundries:		
Revenue Stamps in full	25.00	
Total Deductions	20,734.33	20,734.33
Balance Due		$4,265.67

Received of Frank H. Creese & Co., Inc., the sum of $4,265.67 Dollars being in full settlement of the above transaction.

It is agreed that any error or omission in the above settlement will be corrected by the parties hereto.

Dated May 12th, 1936.

JOHN E. WEYER.

15 *Appendix to appellees' brief*

TESTIMONY (pp. 17–20) OF HARRY E. KARR

Direct examination by Mr. FELSENBERG:

Q. Your full name is Mr. Harry Karr?—A. Harry E. Karr.

Q. You are a member of the local Bar?—A. I am.

Q. I believe you are also engaged in the real estate business?—A. Yes.

Q. Have you handled real estate transactions during the course of your practice of law?—A. I have put through a right good many, probably four or five thousand.

Q. How long have you been a member of the Bar?—A. Forty-two years.

Q. And you are still in active practice?—A. I am glad to say I am.

Q. Now, Mr. Karr, in the many years of your practice in putting through settlements, what do you find to be the general custom and usage in real estate transactions with respect to the adjustment of expenses, particularly taxes as between vendor and vendee at the time of sale?—A. Well, for many years the Daily Record Company have been printing contract forms for sale of real estate. Most of those forms have in the body of them, all have in the body of them taxes, ground rent, insurance, to be adjusted to such and such a date. Practically, I would say 95 percent of the contracts that come through when the matter of settlement is being made for the properties, usually has in the contract "adjustments made to date of transfer." That means that when settlement is made, in some instances the seller who would be prompt in the payment of his taxes, and wants to take his full adjustment, he has paid his taxes at the beginning of the year, as soon as the bill is rendered,

16 and in that event the adjustment is made by the buyer paying back to him the number of days which have been paid in advance. Of course, there are a great many cases where the seller has not paid his taxes and the reverse takes place. Making up the settlement sheet the seller allows credit on account of the purchase for the number of days for taxes which he should have paid.

Q. Now, Mr. Karr, this form of the Daily Record that you refer to, that has been more or less the adopted form that is generally used in the real estate trade?—A. A great many real estate offices have made up their own forms and had them printed, and some of them have something more elaborate. Of course, if you would go into any of the stationery stores to buy forms of contract to buy and sell real estate you would get a form substantially as I have said.

Q. Substantially the form of the Daily Record?—A. Yes.

TESTIMONY (pp. 48-9) OF ALLEN G. BASS.

Direct examination by the COURT:

Q. And you say the quite uniform practice up to two or three years ago was for taxpayers to make deductions in the case of purchases of property and adjustment of taxes for a particular year?—A. I can not speak for anyone else, but for the tax returns I prepared I did allocate the expenses and income.

Q. Over what period of years, from 1913 on?—A. I have been in the tax practice before 1913.

Q. You have been doing it right along for your clients?—A. Yes, sir.

Q. Have you ever known of any rejection of such deductions?—A. I have never had one on one of the returns I prepared, but as stated, there have been a very large number of such cases that have come up in other jurisdictions recently.

17 Q. I understand that. I am asking you about the uniform practice as far as you know it up until 1938.—A. I can say to the extent of my practice and of my organization in preparing returns we uniformly pro rate interest and taxes.

Q. Ernst & Ernst are accountants having main offices where, New York or Cleveland?—A. Cleveland is the home of our managing department.

Q. Where do they have branch offices, in how many cities?—A. I think we have forty-six.

Q. Throughout the United States?—A. Yes, sir.

TESTIMONY (pp. 56-8) OF LOUIS J. JIRA

Direct examination by Mr. FELSENBERG:

Q. You are a member of the Baltimore Bar?—A. Yes, sir.

Q. You are also connected with the Maryland Title & Guarantee Company?—A. That is right, vice president.

Q. You have been practicing law for how many years?—A. Since 1912.

Q. I believe you more or less specialize in the field of real property?—A. That is correct.

Q. During the period of years you have been practicing law, you have had occasion to put through many settlements of real estate between buyer and seller, have you not?—A. That is correct.

Q. In your experience you have seen many contracts drawn between the buyer and seller, have you not?—A. Yes, sir; I have.

Q. Now, in Baltimore City particularly, what do you find to be the custom, usage, and practice with respect to adjustment
18 of state and city taxes between vendor and vendee?—A. To the date of settlement as fixed by the terms of the contract.

Q. What does the usual contract provide, or the adopted practice with respect to the contract provide?—A. It usually provides that taxes shall be adjusted between vendor and vendee of a particular date—taxes due and unpaid and taxes which have been paid, both ways.

TESTIMONY (PP. 62–65) OF HOWARD A. SCHNEPFE

Direct examination by Mr. FELSENBERG:

Q. Mr. Schnepfe, what is your profession?—A. I am a certified accountant.

Q. You have offices in Baltimore City?—A. Yes, sir.

Q. Where is your office?—A. Baltimore Trust Bldg.

Q. How long have you been a certified public accountant?—A. I think I received my certificate in 1925.

Q. And you have been in active practice ever since?—A. I was in practice before, since 1918.

Q. During your practice as a certified public accountant, have you had occasion to make out income-tax reports for various people?—A. Yes.

Q. Have you had occasion to make out income-tax reports for people who had purchased certain real estate with respect to the adjustment of taxes and so forth?—A. Quite frequently.

Q. What has been the established practice with respect to the deduction of taxes for income-tax purposes in the report to the Federal government, so far as you know?—A. Our practice has been to prorate the taxes.

By Mr. FELSENBERG:

Q. Between whom?—A. The purchaser and seller.

Q. And in filing the report with the Internal Revenue Collector, how much of that portion would charge off
19 insofar as the purchaser was concerned?—A. It would depend on when the agreement was entered into, the date of settlement.

Q. Let me give you this specifically: Suppose a purchaser purchases a piece of property on March 1 of a given year and he paid the taxes himself from March 1st until December 31st of that year. That would be ten months. In filing the income-tax report what was your policy with respect to deductions? How much would you take off?—A. The purchaser would take off 10/12. The seller would take off the remaining.

Q. That is between the seller and buyer?—A. Yes, sir.

Q. How about the buyer when he makes out his income-tax report? how much will he deduct from his income tax?—A. He would deduct his pro rata proportion, it would be 10/12.

Q. And that has been your established practice?—A. That has been our practice.

By the COURT:

Q. Have you continued that practice up to today?—A. Yes, sir. We are doing that because of the fact that we think that is the proper way as far as accounting is concerned.

Q. What have you to say to the suggestion that in a situation like that the purchaser ought not to take the deduction for his proportion of the year's taxes, but to capitalize that tax adjustment into his purchase price.—A. Well, we use the basis of the contract as the purchase price in establishing whether there is a profit or loss. We feel as though the tax attaches as of January 1st and is paid in advance, that the tax follows the property, and we feel regardless of who owns it there is a certain deduction for the particular length of time that person owns the property.

20 TESTIMONY (PP. 66–69) OF MELVIN E. DIFFENBAUGH

Direct examination by Mr. FELSENBERG:

Q. Mr. Diffenbaugh, what is your profession?—A. Assistant Auditor of Union Trust Company.

Q. How long have you been connected with the Union Trust Company?—A. Twelve years.

Q. Are you familiar with the transactions in which Mr. Supplee and the company that you are employed by had sold certain properties and purchased by Mr. Supplee?—A. The Royal Realty Corporation.

Q. Are you familiar with that transaction?—A. Yes.

Q. The Royal Realty Company is a certain subsidiary, I believe, of the Union Trust Company.—A. That is right.

Q. And so you are familiar with the transactions?—A. Yes.

Q. What is that sheet you have there?—A. That is 2325 to 33 Reisterstown Road, original ledger sheet. On April 21, 1936, a deposit of $200 was made on the purchase, the purchase price being,

$25,000. On May 12, 1936, the settlement was made at which time the tax bill was turned over to the purchaser the amount being $1,143.99. He was allowed an adjustment of $398.67 from January 1 to May 12, so that the Royal Realty Corporation's expense for that year amounted to $398.67, and the purchaser's expense $745.32.

Q. I direct your attention particularly to your own taxes that you were charged with in this settlement, and ask you whether if that particular property was sold on May 12th of that year and your firm paid a proportionate amount of taxes from January 1 until May 10, 1936, for how much of that tax did you ask an allowance in your income-tax return, if you filed one? First, did you file an income-tax return for your firm?—A. Yes.

21 Q. How much tax allowance did you claim, talking about it proportionately now? Did you claim for the entire year or claim only for the proportionate year from January 1 to May 12?—A. From January 1 to May 12.

Q. And it was the same type of allowance that you claimed in all your other properties that Mr. Supplee purchased?—A. The same nature.

By the COURT:

Q. I did not quite understand whether what you are telling me was knowledge coming from your position as treasurer or assistant auditor of the Union Trust, or whether your connection with the Royal Realty Corporation as separate and apart?—A. The Royal Realty Corporation is a subsidiary of The Union Trust, and it acquires this property—it is a holding company.

Q. And your practice has been to handle the tax deductions and income tax accounting in the same way Mr. Supplee did?—A. Yes, sir.

Q. How long have you been doing that, for how many years?—A. Since 1930.

Q. You have had numerous such transactions in each year?—A. Yes, sir.

Q. And you have made income tax returns every year?—A. Yes, sir.

Q. And never had any of them questioned or revised on account of the tax deduction you made?—A. No, sir.

G. C. M. 6667, VIII-35-4324

REVENUE ACT OF 1928

"The ownership of property in the State of Washington on March 1 is the 'event' which determines the liability for both real estate and personal property taxes and fixes the amount,

although not ascertainable on that date. (Recommended that I. T. 2377 (C. B. VI–2, 59) be revoked.)

22 "An opinion is requested relative to the accrual date of property taxes in the State of Washington.

"In General Counsel's Memorandum 6273 (C. B. VIII–1, 168), involving the accrual date of property taxes in the State of Illinois, it was held that under the laws of Illinois the ownership of property on April 1 is the 'event' which determines the liability for property taxes and fixes the amount, although not ascertainable on that date. (See also G. C. M. 6272, C. B. VIII–1, 170, involving the accrual date of property taxes in the State of Texas.)

"An analysis of the statutes of the State of Washington and certain court decisions thereunder leads to the conclusion that both real and personal taxes accrue on March 1. Section 11097 of Remington's Compiled Statutes of Washington, 1922, provides that all real and personal property shall be subject to assessment and taxation upon equalized valuations thereof, fixed with reference thereto on the 1st day of March, 12 o'clock meridian, in each and every year in which the same shall be listed.

"Section 11109 provides that all real property shall be listed and assessed biennially in every even-numbered year with reference to its value on the 1st day of March preceding the assessment, and that personal property shall be listed and assessed every year with reference to its value on the 1st day of March preceding the assessment; provided, further, that all real estate subject to taxation shall be listed by the assessor every year in the detailed and assessment list, and in each odd-numbered year the valuation of each tract for taxation shall be the same as the valuation as equalized by the county board of equalization in the preceding year.

"Section 11110 provides that the assessor shall complete the listing and placing of values on all real property by May 31 of each even-numbered year and on personal property annually.

23 "Section 11127 provides that the owner of personal property moving from one county to another between the 1st day of March and the 1st day of July shall be assessed in either in which he is first called upon by the assessor. The owner of personal property moving into the State from another State between the 1st day of March and the 1st day of July shall list the property owned by him on the 1st day of March of such year in the county in which he resides.

"Section 11137 requires owners or agents to file with the assessor a list of all personal property owned on March 1, 12 o'clock m.

"Provision is made for a board of equalization for the correction of errors, for the actual levy of the tax and its collection, the latter generally beginning in January of each year.

"Section 11272 provides that the taxes assessed upon real property shall be a lien thereon from and including the 1st day of March in the year in which they are levied until the same are paid. The taxes assessed upon personal property shall be a lien upon all the real and personal property of the person assessed from and after the date upon which such assessment is made.

"In Klickitat Warehouse Co. v. Klickitat County (42 Wash., 299, 84 Pac. 860) the Supreme Court of Washington held that the lien for taxes on personal property attaches to the personal property and real estate of the person assessed immediately when such property is listed with the county assessor, and he has placed his value thereon. This case was followed in city of Puyallup v. Lakin (45 Wash., 368, 88 Pac. 578), in which it was said that the word "assessment" as used in the law meant the valuation of property for taxation by the assessor and not the levy of taxes by the commissioners. It should be noted that these decisions did not mean that there was no liability for the taxes prior to the date the lien attached,
24 as is clearly indicated by the decision of the same court in Sloan Shipyards Corporation v. Thurston (111 Wash., 361, 190 Pac., 1015). In this case the plaintiff alleged that the property assessed to it was not its property, and that it did not own the property on the 1st day of March 1918, the date fixed by law as of which the property was required to be assessed. It appears that the plaintiff had filed with the assessor a list of personal property on March 11, 1918, and later contended that two of the four items listed were not owned by it on March 1, 1918; consequently, that it was not liable for the tax on those items. In denying the plaintiff's contention the court said:

"The rule in regard to the ownership of property for the purpose of taxation is stated in 37 Cyc., at p. 788, as follows:

" 'Ordinarily, and in the absence of statute to the contrary, property is taxable only to the person who is the owner thereof at the date for its listing or assessment, or the date fixed by statute as of which its ownership for purposes of taxation is to be determined; and taxes are not a lawful charge on property unless assessed in the name of its owner, and any attempt to enforce the payment of taxes assessed and charged to the wrong person will be ineffective. * * *

* * * * *

"* * * We are satisfied, therefore, that the trial court properly found that the appellant for the purpose of assessment was the owner of the property on the 1st day of March 1918, and is therefore liable for the whole tax.'

"In view of the Washington statutes and decisions cited, this office is of the opinion that the ownership of property in Washington on March 1 is the 'event' which determines the liability for both real estate and personal property taxes and fixes the amount, although not ascertainable on that date. (G. C. M. 6273, G. C. M. 6272, supra.) It is recommended that I. T. 2377 (C. B. VI-2), 59, holding that property taxes accrue upon delivery of the tax rolls or lists to the treasurer or collector of taxes be revoked.

C. M. CHAREST,
General Counsel, Bureau of Internal Revenue."

TESTIMONY (p. 12) OF FREDERICK M. SUPPLEE

Direct examination by Mr. FELSENBERG:

Q. In filing your income tax return for these properties you also claim only that portion of the year in which you actually owned the property?—A. Yes, sir.

In United States Circuit Court of Appeals for the Fourth Circuit

No. 4825

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, APPELLANT

v.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, APPELLEES

Appeal from the District Court of the United States for the District of Maryland

Argument of cause

November 11, 1941 (November Term, 1941), cause came on to be heard before Parker, Soper, and Dobie, Circuit Judges, and was argued by counsel and submitted.

28 United States Circuit Court of Appeals, Fourth Circuit

No. 4825

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, APPELLANT

v.

FREDERICH M. SUPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE, APPELLEES

Appeal from the District Court of United States for the District of Maryland, at Baltimore

(Argued November 11, 1941. Decided November 12, 1941)

Per Curiam opinion

Filed Nov. 12, 1941

Before PARKER, SOPER, and DOBIE, Circuit Judges.

Morton K. Rothschild, Special Assistant to the Attorney General (Samuel O. Clark, Jr., Assistant Attorney General; J. Louis Monarch and Michael H. Cardozo, IV, Special Assistants to the Attorney General; Bernard J. Flynn, U. S. Attorney, and T. Barton Harrington, Assistant U. S. Attorney, on brief) for Appellant, and Nathan J. Felsenberg (James M. Hoffa on brief) for Appellees.

PER CURIAM: The majority of the court are of opinion that the judgment appealed from should be affirmed on the opinion of the court below and on the authority of the decision of this court in Commissioner v. Rust's Estate, 4 Cir., 116 F. 2d 636. Judge Parker dissents on the ground that the taxes paid, being a lien on the land and a personal liability of the vendor at the time of the conveyance to the taxpayer, were not deductible by the latter from income, for the reasons set forth in the dissenting opinion in the Rust case.

Affirmed.

A true copy,

Teste:

_____, *Clerk,*

U. S. Circuit Court of Appeals, 4th Circuit.

29 In United States Circuit Court of Appeals

Judgment

Filed and entered November 12, 1941

This cause came on to be heard on the transcript of the record from the District Court of the United States for the District of Maryland, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed with costs.

November 12, 1941.

JOHN G. PARKER,
U. S. Circuit Judge.

On another day, to wit, December 13, 1941, the mandate of this court, in this cause, is issued and transmitted to the District Court of the United States for the District of Maryland, at Baltimore, in due form.

Clerk's certificate

UNITED STATES OF AMERICA,
Fourth Circuit, ss:

I, Claude M. Dean, Clerk of the United States Circuit Court of Appeals for the Fourth Circuit, do certify that the foregoing is a true copy of the appendix to the brief of the appellant, the appendix to the brief of the appellees, and the proceedings in said circuit court of appeals in the therein entitled cause, as the same remain upon the records and files of the said circuit court of appeals, and constitute and is a true transcript of the record and proceedings in the said circuit court of appeals in the said cause, made up in accordance with the direction of the Solicitor General of the United States, for use in the Supreme Court of the United States on an application for a writ of certiorari.

In testimony whereof I hereto set my hand and affix the seal of the said United States Circuit Court of Appeals for the Fourth Circuit, at Richmond, Virginia, this twenty-seventh day of January, A. D. 1942.

[SEAL]

CLAUDE M. DEAN,
Clerk U. S. Circuit Court of Appeals,
Fourth Circuit.

30 Supreme Court of the United States

Order allowing certiorari

Filed March 16, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fourth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

31 In the Supreme Court of the United States

Stipulation as to record filed March 30, 1942

Subject to this Court's approval, it is hereby stipulated and agreed by and between the attorneys for the respective parties hereto that for the consideration of this case on the writ of certiorari to the Circuit Court of Appeals for the Fourth Circuit granted March 16, 1942, the printed record may consist of the following:

1. The material contained in the printed transcript of record (consisting of 30 pages) used for the purposes of the petition for writ of certiorari herein.

2. The stipulation of facts filed in the District Court and contained in the certified transcript of record before this Court in this proceeding, at pages 7–8.

3. This stipulation.

It is further agreed that in the briefs for either party reference may be made to any portion of the transcript of record which is not included in the printed record prepared as aforesaid.

CHARLES FAHY,
Charles Fahy,
Solicitor General of the United States,
Counsel for Petitioner.

NATHAN J. FELSENBERG,
Nathan J. Felsenberg,
Counsel for Respondents.

Dated this 20th day of March, 1942.

[File endorsement omitted.]

U. S. GOVERNMENT PRINTING OFFICE: 1942

No. 947

In the Supreme Court of the United States

OCTOBER TERM, 1941

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, PETITIONER

v.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 947

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, PETITIONER

v.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of M. Hampton Magruder, Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in the above cause on November 12, 1941, affirming the decision of the District Court of the United States for the District of Maryland.

OPINIONS BELOW

The opinion of the District Court (R. 14–25) is reported at 36 F. Supp. 722. The opinion of the

Circuit Court of Appeals (R. 28) is reported at 123 F. (2d) 399.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 29) was entered on November 12, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondents purchased real estate and thereafter paid the local property taxes which had previously accrued as a personal liability against the vender and for which a lien had attached prior to sale. May the respondents deduct any portion of those property taxes from their gross income under Section 23 (c) of the Revenue Act of 1936, or must the payment of those taxes be treated as part of the cost of the property?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 8–11.

STATEMENT

The facts, as stipulated and as set forth in the opinion of the District Court (R. 15–16), may be summarized as follows:

The respondents purchased various parcels of real estate in Baltimore, Maryland, during the years 1936 and 1937. At the time of each purchase local real estate taxes for the calendar year

in question had already accrued. These taxes were thereafter paid in full by respondents. The respondents, however, had entered into arrangements with their vendors that there was to be a downward adjustment in the purchase price equal to the portion of the tax allocable to the period prior to purchase.

The question herein is whether respondents may deduct from their gross income the portion of those real estate taxes allocable to the period after purchase. The Commissioner refused to permit such deductions on the ground that the local taxes for the entire calendar year had already accrued against respondents' vendors in each instance and that respondents' payment of such taxes merely constituted part of the cost of the property, no part of which could be deducted from current gross income. Respondents thereupon brought suit for refund in the District Court, which ruled in their favor, and the court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the taxpayers were entitled to deduct as taxes paid or accrued within the years the sums paid to the local taxing authorities.

2. In holding that the payments involved herein were properly designated as taxes rather than capital expenditures constituting part of the purchase prices of the properties.

3. In failing to hold that the taxpayers were not entitled to deduct the sums paid to the local taxing authorities in discharge of the tax liability on the property purchased during the tax years.

4. In affirming the decision of the District Court.

REASON FOR GRANTING THE WRIT

The question whether a purchaser of real estate may deduct local property taxes paid during the year of purchase has long been a troublesome one in the administration of the revenue laws. In attempting to solve the problem the Treasury has adopted as its guiding principle the statement in the regulations that "* * * In general, taxes are deductible only by the person upon whom they are imposed * * *." Regulations 94, Article 23 (c)–1. When the local taxes are "imposed" upon the vendor, the Treasury has disallowed the deduction to the vendee, even though the vendee has paid the taxes pursuant to agreement with the vendor; in that situation the payment of the local taxes is regarded by the Treasury simply as an additional element of cost of the property to the vendee. And it has treated the local taxes as being "imposed" upon the person who owned the property at the time of assessment.[1] The

[1] The refusal of some courts to accept these basic principles has led to a confusing pattern of informal rules. See I. T. 3527, 1942–4 Int. Rev. Bull. 3; G. C. M. 22613, 1941–1 Cum. Bull. 301; G. C. M. 18929, 1937–2 Cum. Bull. 91; G. C. M. 15305, XIV–2 Cum. Bull. 80 (1935); G. C. M. 3667, VIII–2 Cum. Bull. 94 (1929).

decisions of the lower courts and the Board of Tax Appeals, however, have been in hopeless confusion [2] and they have often paid but scant attention to the regulations and the Treasury practice.

In view of the comparative unimportance of the issue on the merits the Government has hitherto refrained from asking this Court to review the question, hoping that it might ultimately be satisfactorily clarified by the lower courts. However, the decisions of the lower courts have become increasingly confusing and have proceeded upon conflicting theories. In the circumstances, the Government believes it to be essential to the orderly administration of the revenue laws that the controlling principles be authoritatively laid down by this Court.

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[2] See, for example, *Commissioner* v. *Rust's Estate*, 116 F. (2d) 636 (C. C. A. 4th); *Commissioner* v. *Coward*, 110 F. (2d) 725 (C. C. A. 3d); *Lifson* v. *Commissioner*, 98 F. (2d) 508 (C. C. A. 8th), certiorari denied, 305 U. S. 662; *Walsh-McGuire Co.* v. *Commissioner*, 97 F. (2d) 983 (C. C. A. 6th); *Hord* v. *Commissioner*, 95 F. (2d) 479 (C. C. A. 6th); *Parrott Estate Co.* v. *McLaughlin*, 89 F. (2d) 188 (C. C. A. 9th); *Merchants Bank Bldg. Co.* v. *Helvering*, 84 F. (2d) 478 (C. C. A. 8th); *Falk Corp.* v. *Commissioner*, 60 F. (2d) 204 (C. C. A. 7th); *Commissioner* v. *Plestcheeff*, 100 F. (2d) 62 (C. C. A. 9th); *United States* v. *City of Buffalo*, 54 F. (2d) 471 (C. C. A. 2d), certiorari denied, 285 U. S. 559; *Securities Company of Milwaukee* v. *United States* (E. D. Wis.), decided December 10, 1936, not officially reported, appeal dismissed, 91 F. (2d) 1022 (C. C. A. 7th); *Chamberlain* v. *Commissioner*, 43 B. T. A. 259; *Gatens Investment Co.* v. *Commissioner*, 36 B. T. A. 309; *California Sanitary Co., Ltd.* v. *Commissioner*, 32 B. T. A. 122; *First Bond & Mortgage Co.* v. *Commissioner*, 27 B. T. A. 430.

Thus, the decision below, holding that respondents were entitled to deduct the real estate taxes although personal liability therefor had already accrued against the vendor before the sale and a lien existed at that time,* seems to be in clear conflict with *Lifson* v. *Commissioner,* 98 F. (2d) 508 (C. C. A. 8th), certiorari denied, 305 U. S. 662. There, the deduction was denied because a lien had attached prior to sale. Similarly, the opinions in *Commissioner* v. *Plestcheeff,* 100 F. (2d) 62 (C. C. A. 9th), and *Commissioner* v. *Coward,* 110 F. (2d) 725 (C. C. A. 3d), indicate that those courts are also in disagreement with the court below. In those cases it was assumed by the respective courts that the buyers of the properties would not have been allowed the deductions if tax liens had attached prior to the sales. See also *Commissioner* v. *Patrick Cudahy F. Co.,* 102 F. (2d) 930 (C. C. A. 7th); *Walsh-McGuire Co.* v. *Commissioner,* 97 F. (2d) 983 (C. C. A. 6th).

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*The District Court concluded that a lien had attached and personal liability had been imposed prior to passage of title. This has not been questioned by the respondents, and the Maryland statutes and decisions confirm it. Annotated Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sections 6, 46, 72, 76, and 154; *Free* v. *Greene,* 175 Md. 36; *Baltimore* v. *Perrin,* 178 Md. 101.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

CHARLES FAHY,
Solicitor General.

FEBRUARY 1942.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, * * *.

* * * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

Annotated Code of Maryland (Flack, 1939), Vol. 2, Art. 81:

6. The following property, except as in the next two succeeding sections provided, shall be subject to assessment to the owner and taxation for ordinary taxes in this

State and in the county and/or city specified below:

(1) All real properties in this State, by whomsoever owned, in the county and/or city in which the same are situated.

* * * * *

46. * * *

(b) All ordinary State taxes levied upon assessments made by the county commissioners or the Appeal Tax Court shall be payable on and after the first day of January of the year for which they are levied; provided that no collector in any county or in the City of Baltimore shall be required to receive payments of State taxes before the earliest date on which county or Baltimore City taxes falling due in such year may be payable; and all such State taxes not paid before the first day of October in such year shall thereafter carry interest at the rate of one-half of 1 per cent. for each month or portion of a month until paid.

* * * * *

72. All State, county and city taxes on real estate shall be liens on the real estate in respect of which they are levied from the date they become payable; provided that, except in Montgomery County, where two or more parcels of land are owned by and assessed to the same person or persons, one or more parcels may be sold for taxes upon all or any thereof, and from the date of the filing of the petition for the ratification of such sale by a circuit court, the taxes upon all of such parcels, for non-payment of which one or more of said parcels may be sold, shall be liens upon all the land so sold; and the proceeds of sale shall be distributed with reference to the priorities described by Section 150.

* * * * *

76. After the proceeding required by Section 74 or 75 shall have been had, if any taxes or assessment for state and/or county or Baltimore City purposes of any nature or kind whatsoever, levied or charged against any part or parcel of ground, improved or unimproved, held in freehold or by lease, shall not be paid within the thirty-day period after the service of notice required by Section 74 or 75, the Collector shall proceed within six months from the service of said notice to enforce payment of the same by distraint, levy, or execution upon said parcel of land of the party failing to pay, such levy, distraint, or execution to be made upon the premises and notice thereof to be given with a statement attached showing all taxes due, interest, penalties, and costs, including that of the levy, to the person so in arrears, or one of them, if more than one, if in possession of the property, otherwise to be conspicuously posted on the premises so to be sold for taxes. * * * The power under this section to sell real estate of a delinquent taxpayer for non-payment of taxes, State, county, or city, shall exist notwithstanding the existence of personal property of the delinquent. * * *

* * * * *

154. Any tax may be collected from the person liable under this Article to pay the same by action of *assumpsit* instituted at any time after said tax shall become due and payable, and within the period of limitations prescribed by this Article, and such suit may be maintained notwithstanding the existence of other remedies by way of sale of real estate, or otherwise.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 23 (c)–1. *Taxes.*—Subject to the exceptions stated in this article and articles 23 (c)–2 and 23 (c)–3, taxes imposed by the United States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). * * * In general taxes are deductible only by the person upon whom they are imposed. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1943

No. 947

In the Supreme Court of the United States

OCTOBER TERM, 1941

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND, PETITIONER

v.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the District Court (R. 3–12) is reported at 36 F. Supp. 722. The *per curiam* opinion of the Circuit Court of Appeals (R. 21) is reported at 123 F. (2d) 399.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 12, 1941 (R. 22). The petition for a writ of certiorari was filed Febru-

ary 12, 1942, and was granted March 16, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The respondents purchased real estate pursuant to contracts which provided for the apportionment of current real estate taxes between themselves and their vendors. The purchase in each instance occurred after the date of assessment, after the taxes had accrued as a personal liability against the vendors, and after a lien had attached against the property. May respondents deduct any portion of those taxes from their gross income under Section 23 (c) of the Revenue Act of 1936, or should their payments in respect of those taxes be treated as part of the cost of the property?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 17–23.

STATEMENT

The facts, as stipulated (R. 1–2), and as set forth in the opinion of the District Court (R. 3–5), may be summarized as follows:

The respondents purchased various parcels of real estate in Baltimore, Maryland, during the years 1936 and 1937. At the time of each purchase, real estate taxes for the current year had

not yet been paid, and respondents arranged for an apportionment of the taxes between themselves and the vendors. Respondents agreed to pay the taxes but the vendors undertook to bear the burden of that portion of the taxes that was arithmetically allocable to the fraction of the year that had already expired. Adjustments were accordingly made in the purchase price that reflected that arrangement.

After the passage of title in each instance, the respondents paid the local authorities the full amounts necessary to discharge the tax liability. They sought deductions in their income tax returns for the portion of those taxes "allocable" to the period after purchase. Respondents kept their books on the cash basis.

The Commissioner of Internal Revenue ruled that the amounts in question were not deductible and that they merely constituted part of the cost of the property. In this suit for refund, the District Court held that the amounts were deductible, notwithstanding that the sales took place after the date of assessment, after personal liability had already accrued against the vendors, and after liens had attached to the property. The court below affirmed, Judge Parker dissenting.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the taxpayers were entitled to deduct as taxes paid or accrued within the

years any part of the sums paid to the local taxing authorities.

2. In holding that the payments involved herein were properly designated as taxes rather than capital expenditures constituting part of the purchase prices of the properties.

3. In failing to hold that the taxpayers were not entitled to deduct any part of the sums paid to the local taxing authorities in discharge of the tax liability on the property purchased during the tax years.

4. In affirming the decision of the District Court.

SUMMARY OF ARGUMENT

1. Section 23 (c) of the Revenue Act of 1936 allows a deduction from gross income on account of "taxes," and the Treasury regulations have consistently interpreted the statute as permitting the deduction only to the person upon whom such taxes are "imposed." One may not obtain a deduction by making payment upon the tax liability of another.

In the case of real estate it is the Government's position that the property taxes are "imposed" only upon the person who owns the property on the date of assessment, or the "date of finality" in Maryland. Liability is fixed as of that date; and if the property changes hands thereafter the purchaser may not obtain a deduction on account of his payment of the transferor's taxes. Such

payment would merely constitute an element of cost of the property to the purchaser, and would be reflected in his cost basis.

2. Even if the date of assessment be rejected as controlling, the amounts involved herein may not be deducted for the further reason that liens had attached and that the vendors had become personally liable for the full amounts of the taxes involved prior to sale. In these circumstances, it is plain that respondents' payments were made in order to discharge the tax liability of their predecessors. Those taxes were not imposed upon respondents, and they are therefore not deductible by respondents under Section 23 (c).

ARGUMENT

RESPONDENTS' PAYMENTS IN DISCHARGE OF THEIR PREDECESSORS' LIABILITY FOR PROPERTY TAXES WERE NOT DEDUCTIBLE AS "TAXES" BUT WERE PART OF THE COST OF THE PROPERTY

1. When the real estate was purchased by respondents it had already been assessed for state and city taxes and liability for those taxes had already accrued against the former owners. See *infra*, pp. 14–16. Pursuant to agreement with the vendors, respondents undertook to discharge that liability and they now seek to deduct from their gross income a portion of the amounts which they had thus paid on account of their vendors' liabil-

ity.' The deduction is sought under Section 23 (c) of the Revenue Act of 1936, which provides:[2]

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (c) *Taxes generally.*—Taxes paid or accrued within the taxable year * * *.

The question presented in this case is whether the respondents were paying "taxes" when they made the controverted payments to the local taxing authorities, or were merely discharging a contractual obligation which increased the cost of the property to them. The Treasury Regulations applicable to Section 23 (c) of the Revenue Act of

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[1] They do not seek to deduct the entire amounts paid. They treated the taxes as spread evenly over the entire calendar year and seek to deduct the portion attributable to that part of the year remaining after the date of purchase.

[2] Identical provisions have appeared in the various revenue acts since 1918. See Section 214 (a) (3) of the Revenue Acts of 1918, 1921, 1924, and 1926; Section 23 (c) of the Revenue Acts of 1928 and 1934.

The Revenue Acts of 1913 (Section II-B) and 1916 (Section 5 (a) Third) permitted deductions for taxes "paid within the year." The addition of the word "accrued" in the later Acts was intended merely to cover the case of taxpayers filing returns on the accrual method. Cf. Sec. 48 (c) of the Revenue Act of 1936 which provides that the terms "paid or incurred" and "paid or accrued" shall be "construed according to the method of accounting upon the basis of which the net income is computed under this Part." Accordingly, since respondents herein are on the cash basis of accounting, the word "accrued" has no application to them.

1936 and to the similar provisions of prior Acts state that "in general taxes are deductible only by the person upon whom they are imposed."[3] In accordance with these regulations the Government has consistently maintained that taxes are deductible only by the person upon whom they are "imposed," and it has treated the owner of the property on the date of assessment[4] as the person upon whom real estate taxes are "imposed." If the property changes hands subsequent to this date and the purchaser pays all or part of the assessed taxes, such payment does not establish a basis for the deduction. In those circumstances the payment is merely an additional element of cost of the real estate, something that the purchaser knew he had to pay in order to acquire and retain the property. It is not unlike the payment of a broker's commission. *Helvering* v. *Winmill*,

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[3] Treasury Regulations 94, promulgated under the Revenue Act of 1936, Article 23 (c)–1; Treasury Regulations 86, promulgated under the Revenue Act of 1934, Article 23 (c)–1; Treasury Regulations 77, promulgated under the Revenue Act of 1932, Article 151; Treasury Regulations 74, promulgated under the Revenue Act of 1928, Article 151; Treasury Regulations 69, promulgated under the Revenue Act of 1926, Article 131; Treasury Regulations 65, promulgated under the Revenue Act of 1924, Article 131.

[4] The date of assessment may vary from state to state, and a number of rulings have therefore been issued designating the critical dates for various states. See, for example, G. C. M. 6667, VIII–2 Cum. Bull. 94 (1929); G. C. M. 7235, VIII–2 Cum. Bull. 197 (1929); G. C. M. 18929, 1937–2 Cum. Bull. 91; G. C. M. 21373, 1939–2 Cum. Bul. 82; G. C. M. 22613, 1941–1 Cum. Bull. 301; I. T. 3527, 1942–4 Int. Rev. Bull. 3.

305 U. S. 79. The payment will increase the purchaser's cost basis and will be reflected in the computation of gain or loss upon ultimate disposition of the property, but it may not be deducted in the year of payment as a charge against current income.

2. The decisions of the lower courts on this question have resulted in a confusing pattern. The Government has consistently urged that the deduction must be limited to those persons who pay taxes which are assessed while they own the property, and that payment by a subsequent owner cannot give rise to a deduction. Cf. *Falk Corp.* v. *Commissioner,* 60 F. (2d) 204 (C. C. A. 7th); *Merchants Bank Bldg. Co.* v. *Helvering,* 84 F. (2d) 478 (C. C. A. 8th). However, a number of the decisions have refused to accept the Government's position that the date of assessment is the critical date.

Thus, in *Lifson* v. *Commissioner,* 98 F. (2d) 508 (C. C. A. 8th), certiorari denied, 305 U. S. 662, the taxpayer purchased Minnesota real estate in 1933, after May 1, the date of assessment. The property taxes arising out of the assessment became due and payable on January 1, 1934, and the purchaser paid those taxes during 1934. The court disallowed the deduction, holding that the taxes had been "imposed" upon the prior owner. It based its decision, however, upon the ground

that a lien had attached to the property on May 1, 1933, and not upon the ground that the taxes were assessed as of May 1, 1933. And a number of other cases have appeared to turn upon whether a lien had arisen prior to the date of transfer. *Commissioner* v. *Plestcheeff*, 100 F. (2d) 62 (C. C. A. 9th); *Parrott Estate Co.* v. *McLaughlin*, 89 F. (2d) 188 (C. C. A. 9th); *Helvering* v. *Missouri State Life Ins. Co.*, 78 F. (2d) 778 (C. C. A. 8th); *Johnson County Realty Co.* v. *Commissioner*, 44 B. T. A. 121, now pending before the Circuit Court of Appeals for the Eighth Circuit; *First Bond & Mortgage Co.* v. *Commissioner*, 27 B. T. A. 430; *California Sanitary Co.* v. *Commissioner*, 32 B. T. A. 122; *Grand Hotel Co.* v. *Commissioner*, 21 B. T. A. 890; *Leamington Hotel Co.* v. *Commissioner*, 26 B. T. A. 1004; *John Hancock Mutual Life Ins. Co.* v. *Commissioner*, 10 B. T. A. 736; *Pyramid Metals Co.* v. *Commissioner*, 44 B. T. A. 1087. The uncertainty created by these cases has been increased by another group of decisions which appear to hold that the critical fact is whether or not personal liability for the taxes had attached to the former owner prior to the passing of title. *Commissioner* v. *Coward*, 110 F. (2d) 725 (C. C. A. 3d); *Burchell* v. *Helvering*, 115 F. (2d) 681 (C. C. A. 2d); *Walsh-McGuire Co.* v. *Commissioner*, 97 F. (2d) 983 (C. C. A. 6th); *Gatens Investment Co.* v. *Commissioner*, 36 B.

T. A. 309; *Kohlsaat* v. *Commissioner*, 40 B. T. A. 528.

As will be shown in detail, *infra*, pp. 13–16, the respondents herein are not entitled to the deductions if either of the foregoing groups of cases is correct; for, not only had the real estate become subject to liens before sale, but personal liability had attached to the prior owners. However, we urge these considerations only in the alternative, because we believe the correct result should depend simply upon the date of assessment, and not upon any other complicating factors.

The court below disposed of this case in a *per curiam* opinion based upon its decision in *Commissioner* v. *Rust's Estate*, 116 F. (2d) 636 (C. C. A. 4th). There the taxpayer had purchased District of Columbia real estate after the assessment of local taxes. There was no provision in the local law for personal liability to pay real estate taxes, and the majority of the court found that no lien had attached prior to sale. It allowed the vendee to deduct the payment of the taxes. The court expressly rejected the assessment date as determinative and relied upon the parties' agreement to apportion the tax burden; the apportionment, as in the instant case, was in accord with local custom. Although this case involves not only a lien but also the personal liability of the vendor, the District Court herein nevertheless felt that the

Rust's Estate decision was controlling and that the vendees might deduct that portion of the taxes arithmetically allocable to the period following the sale. The *per curiam* affirmance of the court below apparently indicated approval of the view that the parties' contractual arrangement for apportionment of the tax burden was controlling.

We submit that the disposition below misconceives the basis for the allowance of the deduction as well as the nature of real estate taxes. Section 23 (c) allows the deduction only to the person upon whom the local taxes are imposed. And the parties to a sales agreement cannot by contract change the incidence of the local taxes. It is misleading to speak of real estate taxes as being "applicable" to the period following the date of purchase. Real estate taxes are not like rent, and they are not paid for the privilege of occupying the property for any given period of time, such as a year. Real estate taxes are simply one of the many forms of raising revenue for the support of government, and are imposed because the ownership of real estate is an index of capacity to pay. Cf. Seligman, *Essays on Taxation* (10th Ed.), p. 12. They are generally imposed as of a given day, sometimes referred to as the date of assessment, or the "date of finality" in Maryland. As in the case of "tax day" with respect to personal property the facts as they exist on that day are

determinative of liability. Cf. Cooley, *Taxation* (4th Ed.), Secs. 546, 587; *Baltimore City* v. *Jenkins*, 96 Md. 192;[3] *Hopkins* v. *Van Wyck*, 80 Md. 7. Although it is true that the purchasers herein could not retain the property unless the taxes were paid, it is likewise true that they could not retain it without paying the purchase price. It is therefore no answer to say that the property was burdened with the taxes and that respondents in effect became obligated to pay them. To be sure there was such a burden, but it was one that was contractually assumed. Respondents did no more than to discharge the obligation that became fixed prior to purchase, and in so doing they were not paying taxes that were imposed upon themselves within the meaning of the statute.

We submit that the date of assessment, or "date of finality," should be conclusive, and that a purchaser of the property thereafter may not be regarded as the one upon whom the property taxes are imposed. The purchaser pays those taxes only because of a contractual arrangement, express or

[3] That the date of finality is critical was strikingly illustrated in *Baltimore City* v. *Jenkins*. There, the property in question was owned and used by a church on October 1, 1901, the date of finality for the year 1902. In November 1901 the property was sold by the church, but the court nevertheless held that the property was not subject to tax for the year 1902, because it was exempt on the date of finality, October 1, 1901.

implied, and therefore is not entitled to the deduction granted by Section 23 (c).*

3. We have thus far contended that the date of assessment should be determinative in this type of case. It is the result for which the Treasury has

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* A somewhat similar problem is raised in connection with determining when real estate taxes "accrue" in the accounting sense in the case of taxpayers who keep their books on the accrual basis or in the case of deductions from gross income earned by a taxpayer in the period immediately prior to his death. The decisions of the lower courts and the Board of Tax Appeals on these related questions have similarly failed to adhere to any single consistent theory. See *Friend* v. *Commissioner*, 119 F. (2d) 959 (C. C. A. 7th), certiorari denied, October 27, 1941, No. 608, present Term; *Commissioner* v. *Patrick Cudahy F. Co.*, 102 F. (2d) 930 (C. C. A. 7th); *Carondelet Bldg. Co.* v. *Fontenot*, 111 F. (2d) 267 (C. C. A. 5th); *Cecil* v. *Commissioner*, 100 F. (2d) 896 (C. C. A. 4th); *Helvering* v. *Schimmel*, 114 F. (2d) 554 (C. C. A. 8th); *Atlantic Coast Line R. R. Co.* v. *Commissioner*, 2 B. T. A. 892; *Brown Co.* v. *Commissioner*, 8 B. T. A. 112; *Crown Willamette Paper Co.* v. *Commissioner*, 14 B. T. A. 133; *Crown Zellerbach Corp.* v. *Commissioner*, 43 B. T. A. 541; *Klyce* v. *Commissioner*, 41 B. T. A. 194; *Cloquat Co-Operative Society* v. *Commissioner*, 21 B. T. A. 744; *Citizens Hotel Co.* v. *Commissioner*, 44 B. T. A. 560; *O'Neil* v. *Commissioner*, 31 B. T. A. 727. Cf. G. C. M. 6273, VIII-1 Cum. Bull. 168 (1929); G. C. M. 15305, XIV-2 Cum. Bull. 80 (1935); G. C. M. 15894, XV-1 Cum. Bull. 90 (1936); G. C. M. 6272, VIII-1 Cum. Bull. 170 (1929); G. C. M. 7190, VIII-2 Cum. Bull. 113 (1929); G. C. M. 9459, X-1 Cum. Bull. 169 (1931); G. C. M. 8218, IX-2 Cum. Bull. 106 (1930); G. C. M. 9793, X-2 Cum. Bull. 142 (1931); I. T. 2908, XIV-2 Cum. Bull. 72 (1935); I. T. 2850, XIV-1 Cum. Bull. 61 (1935); I. T. 2495, VIII-2 Cum. Bull. 98 (1929); I. T. 2643, XI-2 Cum. Bull. 81 (1932); I. T. 2995, XV-2 Cum. Bull. 137 (1936); I. T. 2885, XIV-1 Cum. Bull. 64 (1935).

long contended; it represents a sound and comparatively uniform method of disposing of an administratively difficult question. In asking for certiorari the Government had hoped to obtain some such rule of general application which would serve as a guide for the handling of future cases. However, if this Court should reject the date of assessment as controlling, then we submit that the respondents herein are not entitled to the deduction on any other theory. Under local law, liens had become attached to the property prior to purchase and personal liability had become so definitively fixed against respondents' vendors that respondents cannot be treated as having paid "taxes" imposed upon themselves. In a number of the lower court decisions, see *supra*, p. 9, the existence of liens or personal liability prior to purchase has been regarded as decisive of the issue, and if the theories underlying those decisions were followed here, the deductions sought in this case must be denied.

The property purchased on May 10, 1936 is typical. (R. 4.) Respondents thereafter paid both city and state real estate taxes with respect

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[7] A decision based upon personal liability of the vendor or the existence of liens would present administrative difficulties. In some states personal liability for real estate taxes never attaches. See, e. g., *Helvering* v. *Schimmel*, 114 F. (2d) 554 (C. C. A. 8th); *Commissioner* v. *Rust's Estate*, 116 F. (2d) 636 (C. C. A. 4th). In other states it is often difficult to determine the dates on which liens attach.

to a tax year that had already expired in part.[8] The date of finality for both city and state taxes was October 1, 1935,[9] and the taxes were "due and payable" on January 1, 1936.[10] The prior owner had become personally liable[11] for the full amount of the taxes in question long before the sale to respondents. Indeed, had the prior owner sold the property between October 1, 1935, and January 1, 1936, he would still have remained personally liable, and had he gone into bankruptcy after

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[8] The state taxes were imposed annually on a calendar year basis. See Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 26 (a). Pursuant to Sec. 26 (b), the city taxes were imposed in accordance with local law, which apparently was framed upon a fiscal year basis. See Code, Public Local Laws of Maryland (Flack, 1930), Art. 4, Sec. 40.

[9] Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 26 (b), provides that state and local taxes shall have the same date of finality as prescribed by local law. And the date of finality for Baltimore with respect to any tax year is October 1 of the preceding year. See Code, Public Local Laws of Maryland (Flack, 1930), Art. 4, Secs. 40, 171. See also *In re Wells*, 4 F. Supp. 329 (Md.).

[10] See Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 46 (b), which provides that state taxes are payable on January 1. Sec. 46 (a) provides that local taxes shall be payable in accordance with local law, and under local law, Baltimore taxes are due on January 1. See Code, Public Local Laws of Maryland (Flack, 1930), Art. 4, Sec. 40.

[11] Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 154, goes so far as to provide for an action in *assumpsit* for collection. See also *County Commissioners of Frederick County* v. *Clagett*, 31 Md. 210. Moreover, there are internal indicia of personal liability in Sections 74 and 76 of Art. 81, *supra*. See also Baltimore City Code (1927), Art. 46, Sec. 49. That personal liability exists was recently recognized in *Baltimore* v. *Perrin*, 178 Md. 101, 108.

such sale the taxing authorities would have had a provable claim against him. *In re Wells*, 4 F. Supp. 329 (Md.); cf. *Baltimore* v. *Perrin*, 178 Md. 101, 107; *New Jersey* v. *Anderson*, 203 U. S. 483.

Moreover, both the state and the city had liens against the property from the date the taxes became payable,[12] January 1, 1936.

In these circumstances, respondents are not entitled to deduct the amounts which they paid in satisfaction of a liability that had become so firmly fixed against their predecessor. Even under the narrowest theory of the various lower court decisions, the liability which respondents discharged did not constitute taxes imposed upon them within the meaning of Section 23 (c) of the Revenue Act of 1936.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
ARNOLD RAUM,
MICHAEL H. CARDOZO, IV,
Special Assistants to the Attorney General.

APRIL 1942.

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[12] Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 72.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, * * *.

* * * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. In the case of the death of a taxpayer there shall be allowed as deductions and credits for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly allowable in respect of such period or a prior period.

Annotated Code of Maryland (Flack, 1939), Vol. 2, Art. 81:

2. As used in this Article

* * * * *

(20) The phrase "date of finality" shall mean the date as of which taxes are to be levied for the taxable year in question and

upon which assessments become final for such year, subject only to correction as herein authorized.

* * * * *

6. The following property, except as in the next two succeeding sections provided, shall be subject to assessment to the owner and taxation for ordinary taxes in this State and in the county and/or city specified below:

(1) All real properties in this State, by whomsoever owned, in the county and/or city in which the same are situated.

* * * * *

26. (a) All ordinary state taxes shall be levied for the calendar year.

(b) Except taxes required to be levied upon assessments made by the State Tax Commission, all ordinary county and city taxes shall be levied for the same period as now prescribed by local law, and all ordinary state, county and city taxes shall be levied as of the same date of finality as now prescribed by local law * * *.

* * * * *

46. (a) All ordinary county and/or city taxes levied upon assessments made by the county commissioners or by the assessing authority of any city shall be due and payable at the times and in the manner and subject to the same discounts, interest and penalties as now prescribed by local law or ordinance.

(b) All ordinary State taxes levied upon assessments made by the county commissioners or the Appeal Tax Court shall be payable on and after the first day of January of the year for which they are levied; provided that no collector in any county or in the City of Baltimore shall be required

to receive payments of State taxes before the earliest date on which county or Baltimore City taxes falling due in such year may be payable; and all such State taxes not paid before the first day of October in such year shall thereafter carry interest at the rate of one-half of 1 per cent. for each month or portion of a month until paid.

* * * * *

72. All State, county and city taxes on real estate shall be liens on the real estate in respect of which they are levied from the date they become payable * * *

* * * * *

74. Immediately after the first day of January succeeding the date of levy of taxes, the Collector of the several counties, and the City Collector of Baltimore City, shall make out all tax bills which have not been paid with a warning attached thereto that unless the account be paid within thirty days said Collector will proceed to collect the same by distress or execution * * *

* * * * *

76. After the proceeding required by Section 74 or 75 shall have been had, if any taxes or assessment for state and/or county or Baltimore City purposes of any nature or kind whatsoever, levied or charged against any part or parcel of ground, improved or unimproved, held in freehold or by lease, shall not be paid within the thirty-day period after the service of notice required by Section 74 or 75, the Collector shall proceed within six months from the service of said notice to enforce payment of the same by distraint levy or execution upon said parcel of land of the party failing to pay such levy, distraint or execution

to be made upon the premises and notice thereof to be given with a statement attached showing all taxes due, interest, penalties and costs, including that of the levy, to the person so in arrears, or one of them, if more than one, if in possession of the property, otherwise to be conspicuously posted on the premises so to be sold for taxes. * * * The power under this section to sell real estate of a delinquent taxpayer for non-payment of taxes, State, county or city, shall exist notwithstanding the existence of personal property of the delinquent. * * *

* * * * *

154. Any tax may be collected from the person liable under this Article to pay the same by action of *assumpsit* instituted at any time after said tax shall become due and payable, and within the period of limitations prescribed by this Article, and such suit may be maintained notwithstanding the existence of other remedies by way of sale of real estate, or otherwise.

Code, Public Local Laws of Maryland (Flack, 1930), Vol. 1, Art. 4:

40. The Board of Estimates shall, on the first day of October, or as soon thereafter as practicable, in the year nineteen hundred and nineteen, and in each succeeding year, procure from the proper municipal department and shall send, with the said ordinance of estimates, to the City Council, a report showing the taxable basis for the next ensuing fiscal year, and the amount which can reasonably be expected to be realized by taxation for said year. The report shall contain an aggregate statement of all the moneys to be expended dur-

ing the next ensuing fiscal year by the city, as set forth in said ordinance of estimates, as well as of any other sums, if such there be, which the city may be required to expend during the said year for any purpose or purposes not included in the Ordinance of Estimates, and it shall also state the total income which can reasonably be expected to be received by the city for the next ensuing fiscal year from licenses, fees, rents and all other charges, including the amount believed to be collectible from taxes in arrears. The report shall show the difference between such anticipated expenditures and receipts of the city, and shall state a rate for the levy of taxes sufficient to realize the amount required to meet the said difference. In the ordinance making the annual levy of taxes, which ordinance shall be passed by the Mayor and City Council of Baltimore in the month of November in each year, and as soon as practicable after the passage of the Ordinance of Estimates, the Mayor and City Council of Baltimore shall fix a rate of taxation not less than the rate stated in the aforesaid report, so that it shall not be necessary at any time for the city, its officers or agents, to create a floating debt to meet any deficiency, and it shall not be lawful for the city, its officers or agents, to create a floating debt for any such purpose. The taxes levied under said ordinance in the month of November in each year shall be the taxes to be collected for the fiscal year next ensuing after the said month of November, and shall be due and may be paid to the City Collector on or after the first day of January next ensuing. The taxes included in said levy on real estate or chattels real, and on all forms of personal property, includ-

ing shares of stock and other property, valued or subject to valuation by the State Tax Commission, shall be in arrears on the first day of July next ensuing the date of their levy, and the taxes on all forms of property after they become in arrears as aforesaid shall bear interest at the rate of six per centum per annum.

* * * * *

171. The valuation of the property subject to taxation in the City of Baltimore, as it shall appear upon the assessment books of said Court [Appeal Tax Court] on the first day of October in each and every year, shall be final and conclusive, and constitute the basis upon which taxes for the next ensuing fiscal year shall be assessed and levied; provided that the foregoing provision shall not apply to property in the city liable to taxation, and which may have escaped or which may have been omitted in the regular course of valuation, but such property shall be valued and assessed and the owner or owners thereof charged with current taxes and back taxes, not exceeding four years, justly due thereon, whenever the same may be discovered and placed upon the assessment books; and the annual levy for each and every year shall be deemed and taken to have covered and embraced all property which was not assessed, but which ought to have been assessed, for the year for which any such levy was made. The said Court shall, on the first day of October, or as soon thereafter as practicable, in each year, make out and deliver to the City Collector a statement showing the valuation and assessment of all the property subject to taxation in said city, as it shall appear upon the assessment books of

said Court on said first day of October; such statement shall contain a full list of all the real estate as the same has been valued and assessed by blocks, corresponding so far as may be practicable with the block numbers used in the Record Office of the Superior Court of Baltimore City, with the location and description of such piece or parcel of ground so assessed and valued, and also shall contain an alphabetical list of all persons to whom personal property has been assessed. The said statement shall be known as the taxable basis for the next ensuing fiscal year, and after the levy of taxes it shall be designated as the tax roll for said year. Further, the said Appeal Tax Court shall submit to the Board of Estimates on the first day of October, or as soon thereafter as practicable, a statement of the total valuation of the respective classes of property as shown on the annual roll submitted by the Appeal Tax Court of Baltimore to the City Collector. The said Court shall perform such other duties as may be prescribed by law or ordinances not inconsistent with this Charter.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 23 (c)–1. *Taxes.*—Subject to the exceptions stated in this article and articles 23 (c)–2 and 23 (c)–3, taxes imposed by the United States, any State or Territory, or political subdivision of either, possessions of the United States, or foreign countries, are deductible from gross income for the year in which paid or accrued (see section 43). * * * In general taxes are deductible only by the person upon whom they are imposed. * * *

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 947.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND,
Petitioner,

vs.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR RESPONDENTS IN OPPOSITION.

NATHAN J. FELSENBERG,
JAMES M. HOFFA,
Attorneys for Respondents.

The Daily Record Co. Print, Baltimore.

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OPINIONS BELOW.

The District Court's opinion (R. 14-25), is reported in 36 F. Supp. 722.

The opinion (R. 28), of the Circuit Court of Appeals is reported in 123 F. (2d) 399.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered November 12, 1941 (R. 29). The Jurisdiction of this Court, is invoked under Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED.

Whether a purchaser of real estate in Baltimore City who has paid current City and State taxes thereon, assessed prior thereto to the seller, and adjustment of which has been made to the date of sale, may, in his income-tax return, deduct from gross income that part of such taxes representing the time he was the actual owner of the property.

STATUTES INVOLVED.

Revenue Act of 1936:

> "Sec. 23: Deductions from gross income:
> "In computing net income there shall be allowed as deductions:
>
> (a) Expenses * * *
>
> (b) Interest * * *
>
> (c) Taxes Generally—*Taxes paid or accrued within the taxable year*, except * * *" (Exceptions not material here).

STATEMENT.

This is a civil suit by Frederick M. Supplee and Elizabeth G. Supplee, his wife, respondents herein, against M. Hampton Magruder, Collector of Internal Revenue for the District of Maryland, petitioner, to recover $883.51 with interest, by reason of alleged overpayment of income taxes for the taxable years 1936 and 1937.

FACTS.

In November, 1938, the Collector assessed the respondents the following deficiency income taxes for the calendar years 1936 and 1937.

1936		1937	
Tax	$3,399.71	Tax	$646.24
Interest	327.44	Interest	23.46
Total	$3,737.15	Total	$669.70

These amounts were paid by the respondents on November 21, 1938, under protest. Later, and prior to the filing of the amended complaint, appropriate claims for refund of the parts thereof hereafter mentioned were filed with and denied by the Commissioner of Internal Revenue.

Included in the 1936 deficiency assessment is $200.68, and interest, $19.33, which represents the amounts the respondents were compelled to pay the Collector by reason of the disallowance, in computing net income, of deductions for the respondents' proportionate share of the 1936 City and State taxes paid by them on certain parcels of real estate acquired during that year, adjustment of said real estate taxes in this and the following instance, as between buyer and seller, having been made to the dates of sale. Respondents had taken such deductions in their 1936 income tax return.

Similarly, included in the 1937 deficiency assessment is $646.24 and interest, $23.46, representing the amounts the respondents were compelled to pay by reason of the disallowance of deductions for their proportionate share of 1937 City and State taxes paid by them on certain other

parcels of real estate bought by them during that year. They had likewise taken these deductions in their 1937 income tax return.

The Respondents only claimed deductions for the proportionate parts of the State and City taxes for 1936 and 1937 which they had actually paid, and which covered the periods of time they were the actual owners of the properties (R. 25), and the sellers likewise, in their income tax return, claimed deductions on a similar basis (R. 20-1). The Commissioner disallowed these deductions by the respondents on the ground that those taxes had accrued on the properties prior to their acquisition by the respondents, and the payment of any part thereof by them constituted but a part of the purchase price, and was not the payment of "taxes" within the meaning of section 23(c) of the Revenue Act of 1936, under which such deductions were claimed as "taxes paid" during the taxable year.

ARGUMENT.

The sole reason advanced by petitioner for granting the writ is conflicting decisions among the Circuit Courts of Appeal. To show such conflicts petitioner cites the following cases:

Lifson v. Commissioner, 98 F. (2d) 508 (C. C. A. 8th), certiorari denied, 305 U. S. 662;
Commissioner v. Plestcheeff, 100 F. (2d) 62 (C. C. A. 9th);
Commissioner v. Coward, 110 F. (2d) 725 (C. C. A. 3d);
Commissioner v. Patrick Cudahy F. Co., 102 F. (2d) 930 (C. C. A. 7th); and
Walsh-McGuire Co. v. Commissioner, 97 F. (2d) 983 (C. C. A. 6th).

We accordingly analyze those decisions:

In *Lifson v. Commissioner, Lincoln Co.*, in 1932, owned a building which, in May, 1932, it mortgaged. The mortgage was foreclosed on October 7, 1932, and the building purchased at the foreclosure sale by the mortgagee. The law allowed one year thereafter within which the mortgagor could redeem the property. On August 16, 1933, the taxpayer, Lifson, purchased the sheriff's certificate of foreclosure sale from the mortgagee, thereby acquiring the property, and took possession on October 16, 1933. The 1933 real estate taxes on the property became a lien on May 1, 1933, although the amount of the taxes had not at that time been ascertained or levied and they were not due and payable until January, 1934. There was no adjustment of taxes to the date of sale, as in the case at bar, and the purchaser, in effect, expressly agreed to pay the accrued tax, as a part of the purchase price.

That there may be a distinction between cases where buyer and seller, by agreement, prorate the property tax, as in the case at bar, and cases where there is no such agreement, as in the Lifson case, was recognized by the Board of Tax Appeals in the *Lifson case* when (36 B. T. A., p. 594) it used the following language:

> "Since by state law the charge is fixed as of May 1, although not accurately calculated till later, a buyer after May 1 would take it with knowledge of the tax and would negotiate his price accordingly, either to exclude or to include the tax, or perhaps to prorate it. Cf. State v. Northwestern Telephone Exchange Co., 80 Minn. 17; 80 N. W. 1090. *Buying the sheriff's certificate, petitioner had no such choice. She bought the certificate with the burden of the accrued tax attached, and the cost of this certificate included the accrued tax.*" (Italics ours.).

We accordingly submit that the decision in the *Lifson case* is not in conflict with that in the present case, since the facts are materially different.

In *Commissioner v. Plestcheeff*, the facts were these: Husband and wife made a joint return for 1932. On April 5, 1931, the wife's father died, by the terms of whose will, real estate in Washington was devised to the wife. During 1932 the wife paid real estate taxes on the property so devised to her (apparently for the year 1931) and claimed a deduction accordingly on a cash basis. The Commissioner contended that liability for real estate taxes in Washington was fixed as of March 1st, even though the amount of the tax was not ascertainable on that date, and, as the testator was then the living owner of the property, the payment of said taxes by another after the property had, by devise, been acquired by him was not deductible by the new owner, the estate presumably having been alone entitled to the deduction, and then only if paid by it.

The taxpayer contended that under the state statutes, as construed by its courts, the assessed taxes did not become perfected liens until in October, when levies were made.

The Court found that the lien would ordinarily have attached on March 1st, as contended by the Commissioner, but that in that case the relationship between testator and devisee was that of grantor and grantee within a statute (Remington's Revised Statutes of Washington, Sec. 11265) which expressly provided that "as between the grantor and grantee such lien shall not attach until the first Monday in February of the succeeding year", on which date the taxpayer was the owner of the property; that hence the deduction should be allowed.

In deciding the case as it did, all the Court had to find was that the taxpayer was a "grantee" within the meaning of the special statute. Hence all other comments by the Court were mere obiter dicta which does not rise to the dignity of a judicial decision in alleging a conflict of decisions between Circuit Courts of Appeal. We accordingly submit that the Plestcheeff decision does not conflict with the decision in the case at bar.

In *Commissioner v. Coward*, the facts were these: In 1933 two parcels of improved income producing real estate were owned by one X, one of which was acquired (presumably by purchase) by Coward on October 16, 1933, and the other on January 8, 1934. With relation to these two properties Coward paid real estate taxes for the year 1934 promptly as they, in instalments, became payable, on February 1 (the amount being estimated with reference to the taxes for the previous year), May 1, (likewise estimated), August 1, and November 1, 1934 (adjusted to the estimates so as to total the by then determined amount of the 1934 tax.). Had such payments not been made a lien would have attached therefor on December 1, 1934.

In his income tax return for the year 1934, Coward claimed deductions from gross income for "Taxes paid * * * within the taxable year", under 26 U. S. C. A. Int. Rev. Code, 23 (c), which deductions were disallowed. The Commissioner contended that under the law of New Jersey all property is "assessed to the owner thereof with reference to the amount" then owned, on October 1st of each year, and that said real estate taxes accrued on that date (1933), when Coward's predecessor in title owned the property; that therefore, liability for said taxes having become fixed as of that date, their subsequent payment by Coward converted them from taxes in the ordinary sense, into a

capital expenditure, or part of the purchase price paid by Coward for said properties, and as such they were not deductible.

After examining the reported cases the Court (pp. 727-8) said:

> "Respondent's two parcels were, in theory, already 'liable' for the 1934 taxes when she purchased them. That is to say, nothing which occurred after the assessment of October 1, 1933, could alter the fact that the land itself must ultimately yield those taxes either directly through the eventual foreclosure of a tax lien, or indirectly through the medium of its then or subsequent owner's pocketbook. If, for instance, the land assumed a tax exempt status on October 2, 1933, it would nevertheless, bear its full share of 1934 tax. The presence of this liability in rem may well afford a basis for 'accruing' the tax in the accounting sense. But does its pre-existence deprive the purchaser who later discharges it of his income tax deduction?
>
> We think not. * * *".

The Court accordingly held that the deduction should be allowed. In doing so, that decision supports the decision in the present case, and, we submit, in no way conflicts with it.

In *Walsh-McGuire Co. v. Commissioner*, the decision was based on a construction of the words "accrued within the taxable year", and not on the words "taxes paid * * * within the taxable year", as in the case at bar. Section 23 (c), supra, authorizes deductions for "Taxes paid *or* accrued within the taxable year, * * *". In the Coward case, supra, the Court drew a clear distinction between the two types of cases, saying (p. 727), after referring to the Walsh-McGuire and other similar cases:

> "These have to do with the interpretation of the word 'accrued'. * * * Here, on the other hand, the word under construction is 'taxes' not 'accrued'."

Hence there is no conflict between this case and the case at bar.

In *Commissioner v. Patrick Cudahy F. Co.*, the case also turned on the word "accrued" and not on the word "taxes", and the decision was in favor of the taxpayer. We accordingly submit that it is not in conflict with the decision in the case at bar.

CONCLUSION.

The decision below is correct, there is no conflict of decisions, and the petition should therefore be denied.

Respectfully submitted,

NATHAN J. FELSENBERG,
JAMES M. HOFFA,
Attorneys for Respondents.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 947.

M. HAMPTON MAGRUDER, COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF MARYLAND,
Petitioner,

vs.

FREDERICK M. SUPPLEE AND ELIZABETH G. SUPPLEE, HIS WIFE,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

BRIEF FOR RESPONDENTS.

OPINION BELOW.

The opinion (R. 3-12) of the District Court (also treated as a finding of fact) is reported in 36 F. Supp. 722.

The per curiam opinion (R. 21) of the Circuit Court of Appeals is reported in 123 F. (2d) 399.

QUESTION PRESENTED.

Whether a purchaser of real estate in Baltimore City who has paid current City and State taxes thereon, assessed prior thereto to the seller, and adjustment of which

has been made to the date of sale, may, in his income-tax return, deduct from gross income that part of such taxes representing the time he was the actual owner of the property.

STATUTES INVOLVED.

Revenue Act of 1936:

"Sec. 23: Deductions from gross income:

"In computing net income there shall be allowed as deductions:

(a) Expenses. * * *

(b) Interest * * *

(c) Taxes Generally—*Taxes paid or accrued within the taxable year*, except * * *" (Exceptions not material here).

STATEMENT.

This is a civil suit by Frederick M. Supplee and Elizabeth G. Supplee, his wife, respondents, against M. Hampton Magruder, Collector of Internal Revenue for the District of Maryland, petitioner, to recover $883.51 with interest, by reason of alleged overpayment of income taxes for the taxable years 1936 and 1937.

FACTS.

In November, 1938, the Collector assessed the respondents the following deficiency income taxes for the calendar years 1936 and 1937:

1936		1937	
Tax	$3,399.71	Tax	$646.24
Interest	327.44	Interest	23.46
Total	$3,737.15	Total	$669.70

These amounts were paid by the respondents on November 21, 1938, under protest. Later, and prior to the filing

of an amended complaint, appropriate claims for refund of the parts thereof hereafter mentioned were filed with and denied by the Commissioner of Internal Revenue.

Included in the 1936 deficiency assessment is $200.68, and interest, $19.33, which represents the amounts the respondents were compelled to pay the Collector by reason of the disallowance, in computing net income, of deductions for the respondents' proportionate share of the 1936 City and State taxes paid by them on certain parcels of real estate acquired during that year, adjustment of said real estate taxes in this and the following instance, as between buyer and seller, having been made to the dates of sale. Respondents had taken such deductions in their 1936 income tax return.

Similarly, included in the 1937 deficiency assessment is $646.24 and interest, $23.46, representing the amounts the respondents were compelled to pay by reason of the disallowance of deductions for their proportionate share of 1937 City and State taxes paid by them on certain other parcels of real estate bought by them during that year. They had likewise taken these deductions in their 1937 income tax return.

The respondents only claimed deductions for the proportionate parts of the State and City taxes for 1936 and 1937 which they had paid, and which covered the periods of time they were the actual owners of the properties (R. 20), and the sellers likewise, in their income tax returns, claimed deductions on a similar basis (R. 16-17). The Commissioner disallowed these deductions by the respondents on the ground that those taxes had accrued on the properties prior to their acquisition by the respondents, and the payment of any part thereof by them constituted but a part of the purchase price, and was not the payment

of "taxes" within the meaning of section 23 (c) of the Revenue Act of 1936, under which such deductions were claimed as "taxes paid" during the taxable year.

SUMMARY OF ARGUMENT.

1. The words "taxes paid", contained in Section 23 (c) of the Revenue Act of 1936, must be given their ordinary meaning, i. e., construed to mean *all taxes paid*, and the rights of the income taxpayer thereunder may not be narrowed down by writing exceptions into the Section by construction.

2. The Federal Income Tax Act is to be given a uniform construction of nation-wide application except insofar as Congress has made it dependent on State Law, and Congress, in this instance, has not so provided. By giving the words "taxes paid" in Section 23 (c) their ordinary meaning as contended for by the respondents, all the confusion of which the petitioner complains, disappears, simple uniformity throughout the United States is obtained, and the maze of State and Municipal statutes with which both the petitioner and the taxpayer has heretofore so often had to deal, is eliminated.

ARGUMENT.

ANALYSIS OF DECISIONS.

Before setting out our conclusions on the question presented, we believe it well to analyze chronologically the decisions which heretofore have been rendered, having a bearing thereon.

First. In Falk Corporation v. Commissioner (C. C. A. 7, July 6, 1932) 60 F. (2nd) 204, the Falk Company turned over a large part of its assets to the newly organized Falk Corporation. As a consideration therefor, the Falk Corporation issued to the Falk Company its entire authorized

capital stock and expressly agreed to assume all liabilities of the Falk Company including state income taxes. The Falk Corporation later paid state income taxes assessed against the Falk Company, liability for which the Falk Company did not deny, and claimed deduction therefor in its Federal income tax return as "taxes paid * * * within the taxable year." *Section 234(a) (3), R.A. 1926.* The Court disallowed the deduction, saying (p. 206) in part:

> "It is admitted that the money paid by petitioner to the state of Wisconsin was a part of the consideration for the assets received by it from Falk Company. It was made so by virtue of a contract entered into between Falk Company and petitioner. The amount paid, therefore, was a capital expenditure and of course cannot be deducted from petitioner's income in the determination of its income tax unless there is legislative sanction for doing so."

That case is clearly different from the case at bar in that there, *by express agreement*, the payment of the state income taxes by the corporation was part of the consideration to be paid by the Falk Corporation for the assets which it received.

There is no other way that one could become liable for another's income tax than by voluntary contract, whereas, since a lien exists on real estate for the payment of the taxes thereon, and the State, County and City governments look primarily, if not altogether, to the property for payment, when that lien is enforced the present owner is the first to suffer, even though he did not own the property during the time covered by the tax. Such payment is involuntary. In fact, the present owner, through the enforcement of the lien against his property for taxes accruing before his ownership thereof, may, in many instances be unable to recoup his losses from his predecessor in title,

whatever the relationship between them may be. Hence he is the actual person liable for the taxes regardless of to whom the property was assessed.

This case is also different from the case at bar in that all of the state income taxes paid by the Falk Corporation had fully and actually accrued in the ordinary sense, i. e., by day to day accrual. Real estate taxes, with their peculiar system of assessment, dates of incidence, finality, lien dates, delinquent dates, etc., are assessed by the year, and are payable in advance. During that time title to the property may change many times with attendant equities in the various owners, while state income taxes, involve no such equities.

Second. In Helvering v. Missouri State L. Ins. Co. (C. C. A. 8—July 24, 1934), 78 F. (2d) 778, the Court (p. 781) said:

> "Accrued taxes and assessments upon lands acquired by the taxpayer and paid by it subsequent to acquisition we think were not taxes 'paid during the taxable year exclusively upon or with respect to real estate owned by the company' within the meaning of the Act. Revenue Act 1928, sec. 203 (a) (6), 26 U. S. C. A. section 2203 (a) (6). These taxes were assessed and had become liens upon the lands while in other ownership. The taxpayer took them subject to the lien of the taxes. The liens were in a sense a part of the capital expenditures for the acquisition of the lands, and hence they did not, in a proper sense, pertain to the investment expenditures of the company to be used in determining net income. These taxes stand on an entirely different basis than taxes on real estate accruing after acquisition."

This opinion does not state whether the real estate taxes in question were for periods of time which had fully expired prior to the Federal income taxpayer's acquisition of

the lands, or whether any part of such real estate taxes, assuming a day to day accrual thereof, accrued after such acquisition of the land. As stated by the District Court in the case at bar, we think there is a substantial difference between those instances.

It is also to be noted that in the above case the taxpayer claimed deduction under section 203 (a) (6) of the Revenue Act of 1928, as taxes and other expenses "paid during the taxable year exclusively upon or with respect to the real estate owned by the company", which section relates exclusively to "Net Income of Life Insurance Companies", and not under section 23 (c) of that Act, which latter section is the same as section 23 (c) of the Revenue Act of 1936, here involved.

Third. In Merchants Bank Building Co. v. Helvering (C. C. A. 8, June 16, 1936), 84 F. (2d) 478, the Merchants National Bank in March, 1929, transferred its real estate to Merchants Bank Building, receiving in exchange therefor all of the capital stock of the Merchants Bank Building. At the time of transfer there were assessed and unpaid taxes against the property for the year 1928. Deduction for the payment of such taxes was disallowed the transferee in computing net income for the year 1929, said taxes being regarded as a part of the purchase price.

It is to be noted however that the real estate taxes involved in that case, had, in every sense, fully accrued prior to the transfer of the property and there was no adjustment of the current year's real estate taxes to the date of purchase as in the case at bar.

Fourth. Parrott Estate Company v. McLaughlin, (C. C. A. 9—March 29, 1937), 89 F. (2d) 188. In this case the Parrott Estate Company was a corporation formed by the heirs, legatees, devisees and distributees of Emily Parrott,

deceased, who had assigned their interests in that estate to the Company in return for stock therein. In 1929 the Company was disallowed a deduction in income taxes for inheritance taxes paid to California, and sued to recover the same. The Court found against the Company for four reasons, only the last of which is material in the case at bar. That reason (fourth) was that section 234 of the Revenue Act of 1926 which permitted deduction for taxes paid, did not apply in that instance, for two reasons, one of which was that "it must be assumed (there being no allegations in the pleadings or evidence in the case with relation thereto) that the tax was paid as a part of the purchase price for the property received by it from the legatees and devisees".

That case was different from the case at bar in that in the present case there was a finding that fixed purchase prices were agreed on, with adjustment of taxes to the dates of sale referred to as separate therefrom. In other words, the agreement in the case at bar was that the purchasers would pay the fixed prices for the properties and the taxes from the dates of purchase onward.

Fifth. In Walsh-McGuire Co. v. Commissioner (C. C. A. 6—June 7, 1938), 97 F. (2d) 983, the taxpayer, a corporation, was organized on April 16, 1931, on which date it acquired real estate in Cleveland. Its books were kept on the accrual basis and the item in controversy was a real estate tax for the first half of 1931 (January 1, to June 30), paid February 2, 1932. Deduction of this tax was claimed, presumably in the 1931 return, under Section 23, Revenue Act of 1928, C. 852, 45 Stat. 791, 799, 26 U. S. C. A. Section 23.

Taxes for 1931, under Section 5671, General Code of Ohio, became a lien on April 12, 1931, but the amount of

the 1931 tax assessment was not determined until December 7, 1931. The taxpayer urged that as the tax was not fixed and determinable on April 12, 1931, nor for a long time thereafter the liability did not arise until after its acquisition of the property, and that the amount paid in taxes was deductible because the payment was made in liquidation of its own liability.

The Court said:

"Whether such liability (of petitioner) in fact existed depends upon Ohio law * * *.

"The Ohio decisions construing the statutes which govern this question hold that the amount of the assessment when ascertained relates back to the date of incidence, and hence in legal contemplation both the liability and the amount of tax are determined here as of April 12, 1931. * * * Section 5671, General Code of Ohio, does not require that all legal steps prerequisite to the ascertainment of the amount of the tax be taken before the second Monday in April. The legislature contemplated the computing of amounts after the date of incidence and the assessment, when ascertained, then relates back to the time at which the tax becomes a lien * * *.

"Each person holding the land is required to pay the tax assessed thereon each year. Section 5681, General Code of Ohio. While the taxes are levied and assessed upon the real estate, they are also a personal obligation of the owner of such property. * * * These taxes, then, which accrued on April 12, 1931, prior to the organization of the petitioner's corporation, were the obligations of petitioner's predecessor in title. The payment was made in order to lift the incumbrance from the land, and was a capital expenditure being a part of the cost of acquiring the land * * *.

"* * * The statute authorizes a deduction only by the taxpayer whose property or interests give rise to the deduction * * *. As these taxes were paid to dis-

charge the obligation of petitioner's predecessor in title they were not deductible.

"* * * It is the owner of property who is liable for the tax * * *. Here the vendee had no interest in the property on April 12, 1931."

Here, deduction was claimed under the word "accrued" while in the case at bar the word to be construed is not "accrued", but "paid", within the taxable year. This line of cases is clearly distinguished in Commissioner v. Coward, post.

Sixth. In Lifson, et al., v. Commissioner (C. C. A. 8—August 18, 1938), 98 F. (2d) 508, Lincoln Co., in 1932, owned a building which, in May, 1932, it mortgaged. The mortgage was foreclosed on October 7, 1932, and the building purchased at the foreclosure sale by the mortgagee. The law allowed one year thereafter within which the mortgagor could redeem the property. On August 16, 1933, the taxpayer, Lifson, purchased the Sheriff's certificate of foreclosure sale, from the mortgagee, thereby acquiring the property and took possession on October 16, 1933. The 1933 real estate taxes on the property became a lien on May 1, 1933, although the amount of the taxes had not at that time been ascertained or levied and they were not due and payable until January, 1934.

The Revenue Act of 1934, C. 277, 23 (c), 48 Stat. 680, 688, 26 U. S. C. A. Section 23 (c), provided that in computing net income there should be allowed as a deduction "Taxes paid or accrued within the taxable year" (with certain exceptions not here material). The petitioners contended as follows;

"(1) That the taxes did not 'accrue' on May 1, 1933, because all of the events which fixed the amount of the taxes and which determined the liability of the taxpayer to pay them had not then occurred, and be-

cause there was no personal obligation imposed by the laws of Minnesota upon owners of real estate with respect to real estate taxes—the tax being made a charge against, and lien upon, the land only; (2) that, since Sophie Lifson and her husband made their joint return upon a cash basis, they were entitled to a deduction for 'taxes paid * * * within the taxable year', regardless of when such taxes accrued or become a lien; and (3) that if the doctrine of relation is to be invoked to make the 1933 taxes a lien as of May 1, 1933, the same doctrine should be invoked to make Sophie Lifson the owner of the real estate as of May, 1932, when the mortgage upon which her title is based was executed."

The Court said:

"That Sophie Lifson acquired the Minnesota Building after May 1, 1933, and that at the time she acquired it the taxes for 1933 were, by State statute, a charge against and a lien upon it, cannot be controverted. She certainly had no interest in this real estate until August 16, 1933. The liability of the real estate for the taxes to be levied in 1933 and the lien for those taxes had then accrued.

"(2) When one purchases land which is subject to a lien for taxes, the subsequent payment of those taxes by the purchaser does not constitute an allowable deduction from gross income, for the reason that the taxes accrued while the land was in other ownership and the payment of them is merely a payment of a part of the cost of acquiring the property.

"(4, 5) The fact that the amount of the taxes here involved had not been definitely ascertained at the time the lien attached does not alter the situation * * *. There is no merit in the contention that real estate taxes do not 'accrue' unless they become a personal obligation of the owner of the land. They accrue in Minnesota when they become a charge against and a lien upon the land taxed."

This decision comes nearer to the case at bar than those previously mentioned but, even so, there are differences between them. In the Sheriff's foreclosure sale, the property was undoubtedly sold for a definite price, *and accrued taxes.* In other words, by express agreement, the purchaser agreed to pay the same, and had to do so, in order to obtain the title from the Sheriff. There was no adjustment to the date of sale between the parties as in the case at bar. Neither is there anything to show that a deduction for said taxes was not taken by the prior owner in his income tax return.

That there may be a distinction between cases where buyer and seller, by agreement, prorate the property tax, and cases where there is no such agreement, was recognized by the Board of Tax Appeals in this case when (36 B. T. A., p. 594) it used the following language:

> "Since by state law the charge is fixed as of May 1, although not accurately calculated till later, a buyer after May 1 would take it with knowledge of the tax and would negotiate his price accordingly, either to exclude or to include the tax, or perhaps to prorate it. Cf. State v. North-Western Telephone Exchange Co., 80 Minn. 17; 80 N. W. 1090. *Buying the sheriff's certificate, petitioner had no such choice. She bought the certificate with the burden of the accrued tax attached, and the cost of this certificate included the accrued tax.*" (Emphasis added.)

In other words, *the purchaser expressly agreed to pay the tax as a part of the cost of the property.* There was no such agreement in the case at bar.

Seventh. In Commissioner v. Plestcheeff (C. C. A. 9—Nov. 18, 1938), the facts were these:

Husband and wife made a joint tax return for 1932. On April 5, 1931, the wife's father died, by the terms of whose

will, real estate in Washington was devised to the wife. During 1932 the wife paid real estate taxes on the property so devised to her (apparently for the year 1931) and claimed a deduction accordingly on a cash basis. The Commissioner contended that liability for real estate taxes in the State of Washington was fixed as of March 1st, even though the amount of the tax was not ascertainable on that date, and, as the testator was then the living owner of the property, the payment of said taxes by his daughter after the property had, by devise, vested in her, did not entitle her to a deduction therefor.

The taxpayer contended that under the State statutes, as construed by its Courts, the assessed taxes did not become perfected liens until in October when levies were made.

The Court found that the lien would ordinarily have attached on March 1st, as contended by the Commissioner, but that in that case the relationship between testator and devisee was that of grantor and grantee within a statute (Remington's Revised Statutes of Washington, Sec. 11265) which expressly provided that "as between a grantor and grantee such lien shall not attach until the first Monday in February of the succeeding year", on which date the taxpayer was the owner of the property; that hence the deduction should be allowed.

In deciding the case as it did, all the Court had to find was that the taxpayer was a "grantee" within the meaning of the special statute. Hence all other comments by the Court were mere obiter dicta.

Eighth. In Commissioner v. Coward (C. C. A. 3, February 23, 1940) 110 F. (2d) 725, the facts were these: In 1933 two parcels of improved income producing real estate

were owned by one X, one of which was acquired (presumably by purchase) by Coward on October 16, 1933, and the other on January 8, 1934. With relation to these two properties Coward paid real estate taxes for the year 1934 promptly as they, in installments, became payable, on February 1 (the amount being estimated with reference to the taxes for the previous year), May 1, (likewise estimated), August 1, and November 1, 1934, (adjusted to the estimates so as to total the by then determined amount of the 1934 tax). Had such payments not been made a lien would have attached therefor on December 1, 1934.

In her income tax return for the year 1934, the taxpayer claimed deductions from gross income for "Taxes paid * * * within the taxable year", under 26 U. S. C. A. Int. Rev. Code, 23 (c), which deductions were disallowed. The Commissioner contended that under the law of New Jersey all property is "assessed to the owner thereof with reference to the amount" then owned, on October 1st of each year, and that said real estate taxes accrued on that date (1933), when the taxpayer's predecessor in title owned the property; that therefore, liability for said taxes having become fixed as of that date, their subsequent payment by her converted them from taxes in the ordinary sense, into a capital expenditure, or part of the purchase price paid for the properties.

The Court found the following further facts: On January 10, 1934, the list of assessments which had been in the course of preparation since the first of October previous, was filed with the county board of taxation. Thereupon the board considered the revision of assessments and the amount of revenue to be raised during the current year (1934) for school, state, and local purposes. It fixed the local tax rate on March 10, 1934, and by April 1, 1934, a revised and corrected duplicate list of assessments certi-

fied as a true (and public) record of the taxes assessed was delivered to the collector.

After stating these facts, the Court, in part, said:

"From this welter of chronology, the Commissioner deduces that respondent, who keeps her books on the cash basis, is not entitled to deduct from her gross income for 1934, the real estate taxes paid by her in 1934. As he reasons, the sums paid were not taxes at all, but, rather part of the cost of the two parcels. *The argument is founded on precedent rather than principle*, and proceeds syllogistically as follows. Major premise: One who purchases real estate upon which local taxes have accrued may not deduct the latter payment of those taxes as 'taxes paid'.

Minor Premise: New Jersey real estate taxes had already accrued (at the date of assessment, October 1, 1933) on respondent's properties by the time she acquired them (October 16, 1933, January 8, 1934).

Conclusion: Respondent is not entitled to her deduction.

"The Board denies the minor premise and hence reaches an opposite conclusion, yet in doing so it does not look behind the misleading terminology of accrual employed in both premises. *As a consequence all concerned succumb to the influence of a line of cases which, we think, are completely beside the point. These have to do with the interpretation of the word 'accrued'.* That interpretation, as is expressly provided by statute, 26 U. S. C. A. Int. Rev. Code, sec. 48, lies in the field of accountancy on the accrual basis. The decisions are accordingly directed to the particular point of time when accounts payable (including taxes) may be listed on the taxpayer's books offsetting accounts receivable so as to fairly reflect the taxpayer's net income. See United States v. Anderson, 269 U. S. 422, 46 S. Ct. 131, 70 L. Ed. 347; 3 Paul and Mertens, Law of Federal Income Taxation, 23, 33. *Here, on the other hand, the word under construction is 'taxes' not 'accrued'.* We must determine whether a

given payment is a forced contribution to the expense of Government, or whether it is something else—a voluntary capital expenditure, for example. Its solution must lie in a close analysis of the transaction of payment. It cannot, in our judgment, be solved by any rule of thumb that a property owner's payment is not one of a tax on his property because a prior owner (on the accrual basis) might have been permitted to accrue it. For that permission to accrue it may depend on technical exigencies of accounting utterly foreign to the later owner's economic position in actually making the payment. That being so, our decision may be neither framed within the Commissioner's syllogism, nor guided by the accrual basis cases." (Emphasis added.)

After a review of the cases, the Court found that they suggested only two types of transactions where real estate "taxes" were not "taxes" within the meaning of the statutes, namely, (1), where property is sold and the buyer promises the seller to pay certain taxes on the property, and (2) where a lien for taxes had attached to the property prior to purchase by the taxpayer.

Without commenting on the decisions so holding, the Court said:

"Where, on the other hand, the tax payment falls into neither of these two categories—where it neither discharges (by contract, express or implied) the personal liability of another nor what was originally a tax lien on another's property—the deduction has been permitted."

In the case at bar respondents did not, by contract, either express or implied, agree to assume the seller's liability for the real estate taxes, but on the contrary, the very fact of the adjustment to the date of sale shows that the parties considered liability for such taxes to accrue from day to

day, parallel with actual ownership of the property, and the seller actually paid his portion thereof.

Again the Court in the Coward case said:

"Respondent's two parcels were, in theory, already 'liable' for the 1934 taxes when she purchased them. That is to say, nothing which occurred after the assessment of October 1, 1933, could alter the fact that the land itself must ultimately yield those taxes either directly through the eventual foreclosure of a tax lien, or indirectly through the medium of its then or subsequent owner's pocketbook. If for instance, the land assumed a tax exempt status on October 2, 1933, *it would, nevertheless, bear its full share of 1934 tax.* The presence of this liability in rem may well efford a basis for 'accruing' the tax in the accounting sense. But does its pre-existence deprive the purchaser who later discharges it of his income tax deduction?

(1) We think not. A New Jersey statute provides that in the absence of an express agreement to the contrary the buyer of real estate may hold the seller liable for such proportion of the current year's taxes as the time between January 1 and the date of the deed bears to the full calendar year, * * * *This statute does not affect the lien for unpaid taxes*—the crystallization of the land's liability in rem. So the fact that the property has been assessed prior to sale, does not in the eyes of the New Jersey Legislature mean that the tax resulting from that assessment is to be borne by the seller. *It is always borne by the land in the first instance. But as between buyer and seller it is apportioned on the basis of the calendar year. In other words, it is considered fair that the owner of land in any given year shall be called upon to contribute to the year's revenues only a sum commensurate with the length of the time the land has been held in that year*—except, of course, in the rare case of the prior owner's insolvency. *Such a contribution is, in our judgment a tax in every sense of the word.* * * * We may say that any other conclusion tends to work a

hardship on the taxpayer hardly contemplated by the broad language of the statute. *In this class of cases too great an insistence upon assessment—or, indeed, upon the lien when it relates back to the time of assessment, will often lead to puzzling anomalies.* If all the properties in one state were to change hands immediately after assessment, taxes levied on that assessment would, presumably, be paid by the new owners. The taxes so collected would be used by the state to defray the expenses of the government. Yet should none of the inhabitants of that state be permitted a federal income tax deduction for 'taxes paid'?" (Emphasis added.)

The Court accordingly held that none of the decisions relied on by the Commissioner applied and that the deduction should be allowed.

Ninth., In Commissioner v. Rust's Estate, et al. (C. C. A. 4—December 18, 1940), 116 F. (2d) 636, the facts were these:

On July 1, 1935, and for a number of years prior thereto a parcel of real estate in Washington, D. C., stood on the tax rolls in the name of the decedent's predecessor in title: On or before that date, under the District statutes taxes were assessed against the property for the fiscal year (July 1, 1935—June 30, 1936) then beginning. On July 19, 1935, the tax rate was fixed by the Commissioner and the amount determined, which was payable in two equal installments, in September, 1935, and March, 1936, respectively. On September 17, 1935, the property was purchased by the decedent at a mortgage foreclosure sale. Under the terms of the contract of sale the taxes for the current fiscal year, none of which had been paid, were adjusted to the date of sale and the taxpayer was credited with $3,142.10 representing the portion of the taxes allocable to the period be-

tween July 1 and September 17, 1935. The taxpayer paid the first installment of the taxes, with which he had been credited ($3,142.10), on September 28, 1935, and the second installment on March 31, 1936. Only the second installment was involved in that case, and was claimed as a deduction for taxes paid in 1936. The taxpayer kept his books on a cash basis. The deduction was disallowed by the Commissioner and allowed by the Board of Tax Appeals.

Under the decisions in the District of Columbia the assessment of real estate taxes does not create a personal liability, but only a charge upon the land, nor did any tax lien attach to the land by reason of the assessment. No lien arises prior to the occurrence of a delinquency.

There, the Court, in part, said:

> "Whether or not the deduction could lawfully be taken by the seller, or by the buyer, or partly by one or partly by the other, are questions which should be answered by ascertaining upon whom rests the obligation under the state law to pay the taxes, *having in mind the practicalities of the situation.* Taxes upon real estate constitute an ever recurring burden; and when, as in this case, the property is held as an investment, they are perforce treated as a current expense to be offset against current income. The provision of the agreement of sale that the taxes should be adjusted to the date of sale was therefore natural and proper, since it allotted to each party a part of the burden proportionate to the period during which he possessed the property and enjoyed the income. Such an arrangement between buyer and seller is typical, *and it would be in accord with the facts even if prior to the sale the tax has not only been assessed but has given rise to a lien.* The apportionment of the tax was clearly correct in the transaction under discussion, since no part of the second installment of the tax could be fairly allotted to the seller and no part of it was collectible by

the District during his period of ownership. The burden of paying this installment was an obligation which passed to the taxpayer with the ownership, in much the same fashion that the benefit of certain covenants is held to run with the land in the law of property; and the burden of the tax rested upon the taxpayer in a very real sense, for a delinquency would have been followed by a forced sale by the tax authority.

"The opposing theory advanced by the Commissioner is that in the case of a sale of property, a tax already assessed for the current year cannot be treated by the buyer as an item of current disbursement to be balanced against current income, but becomes a capital item which is added to the purchase price if previously paid by the seller, or subtracted from the purchase price if unpaid at the time of the sale; and, therefore, the tax is not a burden upon the buyer even if he subsequently pays it, because he has already been compensated by the seller. *But this theory is not in accord with the actualities of the ordinary case. The whole tax is not added to or subtracted from the purchase price in a sale during the local tax year, but each party is considered as owing a part of the tax proportionate to his period of ownership. In stating the final account of sale, a sum representing the apportionment may for convenience appear as a debt or credit upon the purchase price, but it is not a part thereof and is not so considered. Furthermore, the Commissioner's theory does violence to the purpose of the income tax statutes that items of income shall be accounted for in annual periods.* Clearly this purpose will not be served if the constantly recurring burden of the tax is refused recognition as an item of current expenses and is placed in the category of a capital expense to be reckoned with under the income tax statutes only in the event of sale at some future date." (Emphasis added.)

The Court there sustained the deduction.

Tenth. We now come to the opinion of the District Court in the case at bar. After stating the principal facts, the Court said:

> "However it is argued for the defendant Collector that, as taxes have been specifically provided for in the statute, the question of their deductibility under the facts of this case must be justified if at all by the particular phraseology of the statute with respect to tax deductions. *The language of this is exceedingly clear and simple. It permits the taxpayer to deduct 'taxes paid or accrued within the taxable year'. * * *. It is also perfectly clear that the taxpayers in this case bring themselves precisely within the literal language of the statute in that they did pay the taxes within the taxable year.* It is however, the contention of the defendant Collector that the phrase 'taxes paid' must be construed as if it read 'taxes paid if assessed on the tax roll to the taxpayer'; and that as so construed the taxpayers in this case are not entitled to the deduction, even though they ask only for the deduction of that portion of the taxes for the whole year which accrued during their ownership of the property and which of course they had to pay to continue in enjoyment of the property. * * *.
>
> "Before beginning the discussion of the point of law thus raised, it is desirable to first refer to the legal incidents of the Maryland taxing system and the customary handling of real estate transactions in Baltimore City. I am referring to these not as necessarily controlling the determination of the particular question, but as a factor to be considered in connection with the defendant's construction of the federal statute. In Maryland taxes on real estate (but not on personal property) become a lien upon the property when due and so continue until paid; (Flack's 1939 Md. Code, Art. 81, Section 72); and are also apparently a personal liability of the owner in whose name the property is assessed on the tax rolls on the date of 'finality'. Md. Code, Art. 81, Sections 2 (20) and 154; Bassett v. Ocean City, 118 Md. 114, 119, 84 A. 262; Free v. Green, 175

Md. 36, 41, 199 A. 857, 117 A. L. R. 717; Mayor and City Council of Baltimore v. Perrin April 4, 1940, 178 Md. 101, 12 A (2d) 261. The taxes with which we are here dealing are those imposed on real estate by the State of Maryland and also those separately imposed under the statutes by Baltimore City. Both classes of taxes become due and payable on January 1st of each year for that current year, although the City taxes are not in default for non-payment until July 1st (after which time if not paid interest and penalties at a prescribed rate accrue thereon), and the State taxes become in default if not paid by January 1st of the succeeding year (Md. Code, Art. 81, Section 74). It is also to be noted that in Baltimore City the date of 'finality' with respect to City taxes is October 1st of the year prior to the taxable year. The person who owns the property on October 1st and is assessed for it on the assessment rolls thereby becomes liable for the taxes for the succeeding calendar year, even though he may sell and dispose of the property between October 1st and January 1st, when the taxes first become actually payable. In re Wells, D. C. Md., 4 F. Supp. 329. It is also to be noted, as appears from the uncontradicted testimony in this case (R. 13-15), that it is the almost universal custom in Baltimore City, and has been for many years, that as between seller and buyer of real estate, taxes are adjusted to the date of settlement and transfer of the property. That is to say, if the settlement date is July 1st the seller is charged with one-half of the tax bill for the whole calendar year and the buyer with the other half, and so proportionately with respect to settlement at any other date during the calendar year. If the taxes have not been paid by the seller prior to the settlement date the purchaser assumes the whole tax bill and is credited with that proportion of the year's taxes which has accrued up to the date of settlement. If the seller has already paid the taxes for the year he is credited with that portion of the taxes allocated to the purchaser. It also appears from the testimony in this case of two experienced

certified public accountants (R. 14-15) that for many years past, in preparing income tax returns for their clients, they have habitually deducted taxes as adjusted between seller and buyer as was done in this particular case by the taxpayer."

The Court then distinguished the cases cited by the defendant (petitioner), stating as follows:

"But it will be found on examination that these cases (with one exception noted) have not dealt with the deduction of taxes adjusted for a current tax year, which is the problem here presented. It is clear enough that unpaid taxes for a prior year, which are properly a charge against income for that year, wholly preceding the new ownership, must be treated as a part of the cost, and (as is almost universally the case in Baltimore City) are credited to the purchaser on the settlement sheet at the time of the transfer of the property. We are dealing here only with taxes for a current year as allocated to the seller in proportion to the period of the year for which he has the ownership. In a similar case the adjusted taxes were allowed to the purchaser as a deduction for the current year in John Hancock Mutual Life Ins. Co. v. Com'r., 10 B. T. A. 736; and see Helvering v. Missouri State Life Ins. Co., 8 Cir., 78 F. 2d 778, 781; and Com'r. v. Coward, 3 Cir., 110 F. 2d 725."

The District Court then referred at length to the recent decision in the case of Commissioner v. Rust's Estate, et al., supra, and continued as follows:

"As pointed out in the Rust case, taxes are an annually recurrent burden on real estate, whether a lien or not. In this respect they are not different from ground rents, water rents and other fixed charges on property. To the extent that they are current they are properly chargeable to maintenance and not to capital by proper accounting practice. They are necessarily a charge against income and not an addition to capital.

On the other hand, unpaid taxes for prior years are not properly chargeable to current income for a subsequent year, and, on a change of ownership of property, necessarily constitute a part of the cost of the property. The statutory provision for the deduction of taxes should be applied in the light of the subject matter. The federal income tax is a tax on *net* and not on *gross* income; and the accounting with the government is put on an annual basis. The general purpose of the income tax is to find and tax the true net income as defined in the statute. This is accomplished only when current taxes and similar items are deducted from the current income. When an income taxpayer purchases investment property he is chargeable only with the income subsequently accruing from the property, and current charges against it are properly deductible to ascertain the net income. If the current income is adjusted to the date of transfer, similarly the current charges against the income shrould be likewise adjusted.

"The federal income tax statute allows deductions for taxes paid or accrued during the taxable year. The wording is plain and simple and, in the context of the whole statute, seems to clearly mean that the current tax burden on property, is to be deducted from current income from the property. In specifically mentioning taxes, in addition to current expenses, Congress probably had in mind the fact that expenses generally are deductible only with respect to a business, while taxes may also be deducted if paid on property owned for personal needs or pleasure, as in case of a dwelling. It is true, as provided in the applicable Treasury regulation (T. R. 94, Art. 34 (C)-1) that in general taxes are deductible only by the person upon whom they are imposed, and this is normally the case. Obviously a gratuitous payment of some other person's taxes would not be deductible by an income taxpayer. *But if the relationship of the taxpayer to the property is such that he must, as a practical matter, pay the tax*

to continue in the enjoyment of the income or use of the property, the statute is gratified because the payment is a necessary charge against the income if any from the property.

"The statute does not condition the deductibility of the taxes paid on the ownership of the property at the time of the assessment for local taxes, or on the particularities of the varying statutory schemes in the several States; and to cut down the taxpayer's right to the deduction by reason of the technical requirements of local taxation seems to contravene the plain words of the federal statute. It also introduces an unnecessary and undesirable lack of uniformity in the administration of the federal statute in the several States. Nor does it necessarily benefit the federal revenue, because, if the purchaser of property must capitalize the current taxes, his profit is less, or less greater, when he resells, and his taxable income is thus diminished.

"It is said for the defendant that in this case the taxpayers have paid the seller's taxes. But this is not so in reality. True the seller remained primarily liable to the local government, but *with respect to the property itself, the purchaser had the direct liability to pay the taxes to save it from tax sale; and legally the purchaser was directly liable to the seller to pay the taxes for the current year which he had assumed in the adjustment.* We must bear in mind that we are applying the federal statute, and the accounting is between the taxpayers and the federal government with respect to what is the net income of the taxpayers. The details of the local tax statutes do not control the matter except insofar as they necessarily affect the determination of the net income. *That the property was subject to a lien for taxes shows that the purchaser who had assumed the taxes was really the person obliged to pay them to avoid the loss of the property, and in paying them he discharged his own obligation, rather than that of another. In accounting*

with the federal government, it is immaterial that, with respect to the local taxing authority, the seller was primarily liable, and the purchaser liable over to the seller. The ultimate legal liability for the taxes was clearly on the purchasers in this case; and as they necessa y sustained the burden of the tax payments, there is no reason to deny them the deduction in their income tax accounting with the federal government. It thus becomes clear that the mere fact that the seller was the owner of the property at the time the local tax assessment was made, and therefore the debtor to the local government, as the named owner on the tax rolls, is legally immaterial in the federal tax problem." (Emphasis added.)

We submit that the reasoning of the District Court is sound in every respect, and we refrain from repeating the arguments therein contained.

RECAPITULATION OF DECISIONS ADVERSE TO TAXPAYER.

In Falk Corporation v. Commissioner, supra, the deduction claimed (payment of state income taxes) was clearly a part of the purchase price because made so by express agreement between the buyer and seller.

In Helvering v. Missouri State Life Ins. Co., supra, section 23 (c), here sought to be construed was not involved; and the opinion does not show whether, assuming a day to day accrual, any part of the real estate taxes claimed as deductions were for periods of time the income taxpayer actually owned the land.

In Merchants Bank Bldg. v. Helvering, supra, the taxes in question were for a year which was fully expired before the transfer of the property took place.

In Walsh-McGuire Co. v. Commissioner, supra, the decision was not based on the words "taxes paid," in Section

23 (c), as in the case at bar, but on the words "taxes accrued", as used therein.

In Lifson v. Commissioner, supra, there was no adjustment of taxes to the date of sale as in the case at bar, and the purchaser, in effect, expressly agreed to pay the accrued tax.

These cases, we think, are not only largely distinguishable from the case at bar but, as was said in Commissioner v. Coward, supra, are "completely beside the point", and the argument adopted therein, "founded on precedent rather than principle". The later cases (Commissioner v. Coward, supra, and Commissioner v. Rust, supra), show a tendency to veer away from them.

ANSWER TO PRESENT QUESTION NOT DEPENDENT ON STATE STATUTES.

Unless we remove from the money paid to the City and State in the case at bar all semblance of "taxes", the deductions should have been allowed as claimed, and consequently the respondents properly recovered in this action.

Section 23 of the Revenue Act of 1936 provides:

> "In computing net income there shall be allowed as deductions:
>
> (a) * * *
>
> (b) * * *
>
> (c) *Taxes paid or accrued within the taxable year*", (with numerous exceptions, not here material).

To disallow the deductions claimed in this case the Court must read into the statute a further exception in substantially these words:

> "Provided, however, that the word 'taxes', as herein used under (c) shall not include money paid in the

> discharge of State and City taxes on real estate by a purchaser who became such after such taxes have become liens thereon.",

or, as the District Court, in its opinion, put it,

> " 'taxes paid' must be construed as if it read 'taxes paid *if assessed on the tax rolls to the taxpayer.*' "

And this amendment must be read into the statute even though, because of the well known variance of state statutes, the citizens of some states would thus bear a heavier burden of Federal income taxes than those of other states. This is in the teeth of the opinion in Thomas v. Perkins, 301 U. S. 655-9, where this Court (p. 659) said:

> "The Federal Income Tax Act is to be given a uniform construction of nation-wide application except insofar as Congress has made it dependent on state law."

And where has Congress said that deductions under Sec. 23 (c) should depend on State law? Again, in Burnet v. Harmel, 287 U. S. 103, at p. 110, this Court said:

> "State law may control only when the federal taxing act, by express language or necessary implication makes its operation dependent upon state law."

Can it be presumed that the intent of Congress was that deductions under the words "taxes paid" in Section 23 (c) should mean only, and be limited to, levies for which there existed no lien at a certain time, or for which the taxpayer was not personally liable; that the citizens of one state should be allowed deductions for monies they paid the State and City governments as taxes, and those of other states should not, dependent entirely on what the state statutes provided relative to liens for taxes and the personal liability of the owners of property for taxes thereon?

Is a tax any the less a tax, whether or not the State or City has a lien for its collection, or whether the owner of property is personally liable therefor?

In short, the question is: When is a tax not a tax within the meaning of Section 23 (c)?

The answer to these questions is obvious; Congress intended the words "taxes paid" to mean monies paid for the support of the government, without regard to state statutes relative to liens or personal liability for property taxes.

In construing this statute, we submit, we must begin with the rule that the word "taxes" as used in Section 23 (c) should be given its ordinary and commonly understood meaning and not one with a hidden condition attached.

> Miller v. Robertson, 266 U. S. 243, 250;
> 59 C. J., p. 975, and cases cited.

In Old Colony R. Co. v. Commissioner, 284 U. S. 552, at p. 560, this Court said:

> "The rule which should be applied is established by many decisions. 'The legislature must be presumed to use words in their known and ordinary signification.' Levy's Lessee v. McCartee, 6 Pet. 102, 110. 'The popular or received import of words furnishes the general rule for the interpretation of public laws.' Maillard v. Lawrence, 16 How. 251, 261. And see United States v. Buffalo Gas Co., 172 U. S. 339, 341; United States v. First Nat. Bank, 234 U. S. 245, 258; Caminetti v. United States, 242 U. S. 470, 485. As was said in Lynch v. Alworth-Stephens Co., 267 U. S. 364, 370, 'the plain, obvious and rational meaning of a statute is always to be preferred to any curious, narrow, hidden sense that nothing but the exigency of a hard case and the ingenuity and study of an acute and powerful intellect would discover.' This rule is applied to taxing acts: De Ganay v. Lederer, 250 U. S. 376, 381."

The Board of Tax Appeals also has recognized and applied to subsection (b) of the same statute, the above broad construction rule in favor of the taxpayer.

In Fackler v. Commissioner, 39 B. T. A. 395, the Board construed section 23 (b) of the Revenue Act of 1934 (later carried over identically into the 1936 Act which we are now considering) which provided for the deduction from gross income of

> "all interest paid or accrued within the taxable year on indebtedness except" (exceptions not there material).

The taxpayer had prepaid interest on borrowed money beyond the year covered by his tax return and had claimed a deduction for the full amount so prepaid, which deduction was disallowed by the Commissioner because of such prepayment. The Board (p. 398), in part, said:

> "Since the contrary does not appear in the statute, the term, 'interest' must be construed according to its ordinary meaning. Old Colony Railroad Co. v. Commissioner, 284 U. S. 552.
>
> * * * Here, whatever other designation, by analogy may be applied to the disputed items—they are 'interest' payments and are thus deductible within these specific provisions of the statute. That they may not[1] have been ordinary or necessary expenses of business of the taxpayer is not a requisite to their deduction under the statute."

In The Northwestern Mutual Life Insurance Co. v. Johnson, State Treasurer, etc., 8 Cal. 2d 42, by Section 14 of Article XIII, of the Constitution of California, insurance companies were required to pay a tax measured by a percentage of the gross premiums received from business done in that State. That section also provided that there should

[1] The word "not" evidently is included by error.

be deducted from the amount of such tax the amount of taxes "paid by such companies on real estate owned by them in this State." The State treasurer contended that this created an exemption as to the real estate taxes rather than an allowable deduction and that hence the provision must be strictly construed against the taxpayer, and that (as an exemption) to be entitled to the claimed deduction the taxpayer must have owned the property on the date the tax became a lien.

The Court, however, held that the amount of State taxes paid on real estate was a deduction and not an exemption from tax, and in part, said:

> "In the absence of language (and there is none) in the constitutional section which would expressly impose the requirement of ownership of the property at the time the taxes on real estate become a lien before the deduction could be claimed, we have no hesitancy in declaring that the time when the offset is to be effective is the time of payment of the current real estate tax.
>
> * * *
>
> "We conclude that there is nothing in the Constitution which would prevent the offset of current real estate taxes paid by the insurance company on property owned by it at the time of payment thereof, although in another's ownership at the time the tax became a lien, and that the reason and purpose of the law as now framed permits and requires such deduction.
>
> "The evidence of any departmental construction, assuming its pertinence, contrary to the conclusion stated is insufficient to justify a different conclusion."

In the case at bar, at the time the real estate taxes were paid for which deductions are sought, the respondents were the actual owners of the property as in the above case.

Although the money paid the City and State by the purchaser is, in a restricted sense, a part of the purchase price, it is still, nevertheless, "taxes" in the *ordinary sense*, and *that is the sense in which it was clearly used by Congress*. Imagine the purchasers in the present case, upon acquiring title, e. g., on July 1st, 1940, going to the City Hall, presenting the tax bills for 1940 theretofore issued to the vendor with reference to the properties purchased, and announcing they wished to pay off the balance of the purchase price of their properties!

The word "tax", in its ordinary sense, means:

> "A pecuinary burden laid on individuals or property for the purpose of supporting the Government." State of New Jersey v. Anderson, 203 U. S. 483.

And, in ascertaining the meaning of Section 23 (c), we must apply the rule that the intent and meaning of a statute should be determined from the statute itself.

> Child Labor Tax Case, 259 U. S. 20;
> Lake County v. Rollins, 130 U. S. 662;
> United States v. Wiltberger, 5 Wheat. 76;
> Barnes v. The Railroads, 17 Wall. 294;
> Boston and M. R. Co. v. United States, 265 F. 578 (C. C. A. 1);
> United States v. Thompson, 189 F. 838;
> 59 C. J., pp 952-3 and cases cited.

As was said by Chief Justice Marshall, in United States v. Wiltberger, supra:

> "The intention of the legislature is to be collected from the words they employ."

In United States v. Mo. Pac. R. Co., 278 U. S., 269, p. 277, the Court said:

> "The language of that provision is so clear and its meaning so plain no difficulty attends its construction

in this case. Adherence to its terms leads to nothing impossible or plainly unreasonable. We are therefore bound by the words employed and are not at liberty to conjure up conditions to raise doubts in order that resort may be had to construction. It is elementary that where no ambiguity exists there is no room for construction. Inconvenience or hardships, if any, that result from following the statute as written must be relieved by legislation. * * * Construction may not be substituted for legislation. United States v. Wiltberger, 5 Wheat, 76, 95-96; United States v. Fisher, 2 Cranch, 358, 386; Lake County v. Rollins, 130 U. S. 662, 670; Caminetti v. United States, 242 U. S. 470; Ex Parte Public National Bank (278 U. S., p. 101); United States v. Colorado & N. W. R. Co., 157 F. 321, 327. * * *

* * * But where the language of an enactment is clear and construction according to its terms does not lead to absurd or impracticable consequences, the words employed are to be taken as the final expression of the meaning intended."

And no policy of the government can change the clear wording of the statute. St. Paul M. & M. R. Co. v. Phelps, 137 U. S. 528.

In Shreeve v. Cheesman, et al. (C. C. A. 8) 69 F. 785, there was a controversy over the matter of court costs recoverable by the successful party. A state statute provided that the defeated party in an action to recover land might, at any time before the first day of the term succeeding that at which judgment is rendered against him, pay all costs recovered by such judgment and thereupon have a new trial of the case. Another statute provided that a successful plaintiff should recover against the defendant his costs to be taxed. The plaintiff, in error, attempted to have the words "costs to be taxed" construed to mean only costs of the last trial.

The Court, in part, said:

> "Moreover, the statute of Colorado needs no interpretation. Its language is simple and plain. 'His costs to be taxed' cannot mean anything less than all his costs in the action to be taxed. The moment an attempt is made to limit these words to a part of his costs, we are met by the unanswerable question: What part? That which was clear and certain becomes a matter of doubt and conjecture. When the meaning of a statute is plain, arguments drawn from the history of the legislation it embodies and the construction given to ambiguous statutes on the same or similar subject serve only to create doubt where none should exist, and to confuse the judgment when it would otherwise be sound and clear. There is no better canon of interpretation than that when a statute is plain and unambiguous, the legislature must be presumed to have intended what it expressed, and no room is left for construction. Knox Co. v. Morton, 68 F. 787; U. S. v. Fisher, 2 Cranch 358, 399; Railway Co. v. Phelps, 137 U. S. 528, 536, 11 Sup. Ct. 168. * * * The statute does not except these costs from the general provision, and it would be judicial legislation for the court to create exceptions to the general provisions of this law when the legislature has made none. Where the legislature has made no exception to the positive terms of a general statute, the conclusive presumption is that it intended to make none, and it is not the province of the courts to do so. Madden v. Lancaster Co., 12 C. C. A. 566, 573, 63 F. 188; Morgan v. City of Des Moines, 8 C. C. A. 569, 60 F. 208; McIver v. Rogan, 2 Wheat. 25, 29; Bank v. Dalton, 9 How. 522, 528; Vance v. Vance, 108 U. S. 514, 521, 2 Sup. Ct. 854."

Now, we would inquire of the petitioner, where is there any ambiguity in the words of Section 23 (c)? We submit no words could be plainer or more easily understood. In United States v. Woodward, 256 U. S. 632, this Court construed these same words ("taxes, paid or accrued within the taxable year") and said:

"* * * Section 214 makes express provision for the deduction of 'taxes paid or accrued within the taxable year, imposed (a) by the authority of the United States, except income, war-profits and excess-profits taxes'. This last provision is the important one here. *It is not ambiguous but explicit, and leaves little room for construction. The words of its major clause are comprehensive and include every tax which is charged against the estate by the authority of the United States. The excepting clause specifically enumerates what is to be excepted. The implication from the latter is that the taxes which it enumerates would be within the major clause were they not expressly excepted, and also that there was no purpose to except any others.* Estate taxes were as well known at the time the provision was framed as the ones particularly excepted. Indeed, the same act, by Sections 400-410, expressly provides for their continued imposition and enforcement. Thus, their omission from the excepting clause means that Congress did not intend to except them."

In view of the above cases it is difficult to see how the courts could be justified in construing the statute here involved as if it contained the exception contended for by the petitioner. The mere fact that the taxpayer retained a right which he may not have been allowed to keep if Congress had had the present question called to its attention before passing the legislation is no excuse for enlarging the law as enacted, by judicial interpretation. As was said in Iselin v. United States, 270 U. S. 245:

"The Statute was evidently drawn with care. Its language is plain and unambiguous. *What the Government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope.* To supply omissions transcends the judicial function. Compare United States

v. Weitzel, 246 U. S. 533, 543; Peoria & Pekin Union Ry. Co. v. United States, 263 U. S. 528, 543, 535."

See also:

Brown v. Maryland, 12 Wheat. 419, 438;
Bend v. Hoyt, 13 Pet. 263, 10 L. ed. 154;
Arnold v. United States, 147 U. S. 494, 37 L. ed. 253.

The law favors the taxpayer, generally, and all doubts as to the construction of revenue statutes must be resolved in his favor and against the taxing power.

United States v. Merriam, 263 U. S. 179;
Gould v. Gould, 245 U. S. 151;
Bowers v. Lighterage Co., 273 U. S. 346;
United States v. Updike, 281 U. S. 489;
Burnet v. Niagara Falls Brewing Co., 282 U. S. 648;
Old Colony R. Co. v. Commissioner, 284 U. S. 552.

With relation to Internal Revenue statutes, it is stated in 59 C. J., at pp. 1131-2, as follows:

> "As a general rule revenue laws, such as laws imposing taxes and licenses are neither remedial laws nor laws founded upon any permanent public policy; but, on the contrary, operate to impose burdens upon the public, or to restrict them in the enjoyment of their property in the pursuit of their occupations, and when they are ambiguous or doubtful, will be construed strictly in favor of the taxpayer and against the taxing power." (Citing Bowers v. New York & Albany Lighterage Co., 273 U. S. 346, and numerous other cases.)

Applying these rules to Section 23 (c) we submit that there is no doubt that Congress intended to allow deductions for *all*,

"Taxes paid or accrued within the taxable year",

with only the exceptions mentioned by the Act itself.

We urge also that Congress, by making specific exceptions to the deductibility of "taxes paid or accrued", in Section 23 (c), thereby brings into play in favor of the respondents, the maxim *expressio unius est exclusio alterius.*

Bank of Alabama v. Dalton, 9 How. 522, 13 L. ed. 242;
United States v. Arredondo, 6 Pet. 725;
Sturges v. Collector, 12 Wall. 19;
Arthur v. Cumming, 91 U. S. 362;
United States v. County Court, 99 U. S. 582;
Walla Walla v. Walla Walla Water Co., 172 U. S. 1.

CONCLUSION.

The judgment of the court below should be affirmed.

Respectfully submitted,

NATHAN J. FELSENBERG,

JAMES M. HOFFA,
Attorneys for Respondents.

April, 1942.

SUPREME COURT OF THE UNITED STATES.

No. 947.—October Term, 1941.

M. Hampton Magruder, Collector of Internal Revenue for the District of Maryland, Petitioner, *vs.* Frederick M. Supplee and Elizabeth G. Supplee, His Wife.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit.

[May 25, 1942.]

Mr. Justice Murphy delivered the opinion of the Court.

During the years 1936 and 1937 respondents purchased various parcels of real estate in Baltimore, Maryland. In each instance the state and city taxes on the real estate for the current year had not been paid at the time of purchase. The various contracts provided for the apportionment of these current real estate taxes, respondents agreeing to pay the amount of the taxes, and the vendors undertaking to bear the burden of that portion of the taxes arithmetically allocable to the fraction of the year that had expired prior to the date of purchase. Adjustments were accordingly made in the purchase prices to reflect this arrangement.

Respondents paid the local authorities the full amounts necessary to discharge the tax liability. In their 1936 and 1937 income tax returns, which were on the cash basis, they deducted that portion of those taxes "allocable" to the periods after purchase. The Commissioner of Internal Revenue ruled that the amounts in question were not deductible under Section 23(c) of the Revenue Act of 1936, 49 Stat. 1648, 1659,[1] but instead were merely part of the cost of the properties. Accordingly, he made a deficiency assessment which was paid under protest. This suit for refund followed. The District Court held the amounts were deductible,[2] and the Circuit Court of Appeals affirmed[3] on the authority of its

[1] Sec. 23. Deductions from Gross Income.
In computing net income there shall be allowed as deductions:

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, . . .

[2] 36 F. Supp. 722.

[3] 123 F. 2d 399.

previous decision in *Commissioner* v. *Rust's Estate*, 116 F. 2d 636. We granted certiorari because of an asserted conflict with *Lifson* v. *Commissioner*, 98 F. 2d 508.

The question for decision is whether the amounts apportioned by respondents on the basis of the fractions of the taxable years remaining after the several purchases constitute "taxes paid within the taxable year" within the meaning of Section 23(c) of the Revenue Act of 1936, 49 Stat. 1648, 1659, and hence are deductible.

The guiding principle for determining whether a payment satisfying a tax liability is a "tax paid" within the meaning of Section 23(c) is furnished by the applicable Treasury regulation, which states that "In general taxes are deductible only by the person upon whom they are imposed".[4] See *Colston* v. *Burnet*, 59 F. 2d 867; *Small* v. *Commissioner*, 27 B. T. A. 1219; Paul, Selected Studies in Federal Taxation, Second Series, p. 24. Resort must be had here to the laws of Maryland and of the City of Baltimore to determine upon whom the state and city real estate taxes were imposed. *Walsh-McGuire Co.* v. *Commissioner*, 97 F. 2d 983, 984; cf. *Helvering* v. *Fuller*, 310 U. S. 69, 74-75; and see Paul, *op. cit. supra*, pp. 23-24.

To illustrate concretely the workings of the Maryland tax system with respect to respondents' purchases the property bought on May 10, 1936, may be taken as typical of all the other transactions. The assessment date, or "date of finality", for both state and city taxes was October 1, 1935.[5] These taxes were for the calendar year 1936[6] and became due and payable on January 1, 1936,[7] although the default date for city taxes was not until

[4] Article 23(c)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936. This is a regulation of long standing. See Treasury Regulations 86, promulgated under the Revenue Act of 1934, Article 23(c)-1; Treasury Regulations 77, promulgated under the Revenue Act of 1932, Article 151; Treasury Regulations 74, promulgated under the Revenue Act of 1928, Article 151; Treasury Regulations 69, promulgated under the Revenue Act of 1926, Article 131; Treasury Regulations 65, promulgated under the Revenue Act of 1924, Article 131.

[5] Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 26(b), provides that state and local taxes shall have the same date of finality as is provided by local law, and the date of finality for Baltimore with respect to any tax year is October 1 of the preceding year. See Code, Public Local Laws of Maryland (Flack, 1930), Art. 4, Sec. 40.

[6] Taxes are imposed annually on a calendar year basis. See Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 26(a) and (b); Code, Public Local Laws of Maryland (Flack, 1930), Art. 4, Sec. 40.

[7] See Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 46(b), which provides that state taxes are payable on January 1. Sec. 46(a) pro-

July 1, 1936, and for state taxes January 1, 1937.[8] Both the state and the city had liens against the property from the due date, January 1, 1936.[9] And, respondents' vendor became personally liable for these taxes before the sale. An action of assumpsit could have been brought against him for the taxes at any time after the due date.[10] Had he sold the property between October 1, 1935 and January 1, 1936, he apparently would still have remained personally liable, and if he had gone into bankruptcy after such sale the taxing authorities would have had a provable claim against him. *In re Wells*, 4 F. Supp. 329; cf. *Baltimore* v. *Perrin*, 178 Md. 101, 107.

It is thus apparent that tax liens had attached against the properties and that respondents' predecessors in title had become personally liable for the taxes prior to any of the purchases. The attachment of a lien for taxes against property before its sale has been held to prohibit the vendee from deducting as "taxes paid", amounts paid by him to discharge this liability. *Lifson* v. *Commissioner*, 98 F. 2d 508; *Walsh-McGuire Co.* v. *Commissioner*, 97 F. 2d 983; *Merchants Bank Building Co.* v. *Helvering*, 84 F. 2d 478; *Helvering* v. *Missouri State Life Insurance Co.*, 78 F. 2d 781. A tax lien is an encumbrance upon the land, and payment, subsequent to purchase, to discharge a pre-existing lien is no more the payment of a tax in any proper sense of the word than is a payment to discharge any other encumbrance, for instance a mortgage. It is true that respondents here could not have retained the properties unless the taxes were paid, but it is also true that they could not retain them without paying the purchase price. It is no answer therefore to say that the property was burdened with the taxes and that respondents became obligated to pay them. There was a burden, but it was contractually assumed. In discharging this assumed obligation respondents were not paying taxes imposed upon them within the meaning of Section 23(c). For "only the person owning the property at that time [i.e., when the tax lien at-

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vides that local taxes shall be payable in accordance with local law, and under local law Baltimore taxes are due on January 1. Code, Public Local Laws of Maryland (Flack, 1920), Art. 4, Sec. 40.

[8] Code, Public Local Laws of Maryland (Flack, 1930), No. 4, Sec. 40; Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 74.

[9] Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 72.

[10] Ann. Code of Maryland (Flack, 1939), Vol. 2, Art. 81, Sec. 154. See County Commissioners of Frederick County v. Clagett, 31 Md. 210; Bassett v. M. & C. C. of Ocean City, 118 Md. 114, 119; Free v. Greene, 175 Md. 36, 41.

taches] is subjected to the burden which the law imposes; and only the person who has been thus subjected to the burden of the tax is entitled to a deduction for paying it. Payment by a subsequent purchaser is not the discharge of a burden which the law has placed upon him, but is actually as well as theoretically a payment of purchase price; for, after the lien attaches and the taxing authority becomes pro tanto an owner of an interest in the property, payment of the tax by a purchaser is nothing but a part of the payment for unencumbered title." Judge Parker, dissenting in *Commissioner* v. *Rust's Estate*, 116 F. 2d 636, 641.

Furthermore, respondents paid taxes for which their vendors were personally liable. This was clearly the payment of a tax imposed upon another and therefore not deductible by respondents. Cf. *Walsh-McGuire Co.* v. *Commissioner*, 97 F. 2d 983; *Gatens Investment Co.* v. *Commissioner*, 36 B. T. A. 309; *Kohlsaat* v. *Commissioner*, 40 B. T. A. 528. And see *Commissioner* v. *Coward*, 110 F. 2d 726, 727.

Thus either a pre-existing tax lien or personal liability for the taxes on the part of a vendor is sufficient to foreclose a subsequent purchaser, who pays the amount necessary to discharge the tax liability, from deducting such payment as a "tax paid". Where both lien and personal liability coincide, as here, there can be no other conclusion than that the taxes were imposed on the vendors. Respondents simply paid their vendors' taxes; they cannot deduct the amounts, or any portion thereof, paid to discharge liabilities so firmly fixed against their predecessors in title by the laws of Maryland.

The view of the court below that the parties' contractual arrangement for apportionment of the tax burden was controlling is untenable.[11] Parties cannot change the incidence of local taxes by their agreement. And it is misleading to speak of real estate taxes as "applicable" to the fractional part of a tax period following purchase. Such taxes are simply one form of raising revenue for the support of government. They are not like rent, nor are they paid for the privilege of occupying property for any given period of time.

The judgment below is

Reversed.

[11] The opinion below was a per curiam affirmance on the authority of Commissioner v. Rust's Estate, 116 F. 2d 636. The Court there relied on the fact that the parties had agreed to apportion the tax obligation. p. 640.